

A CRITICAL ANALYSIS OF THE SMALL BUSINESS
ASSISTANCE PROGRAMS OF THE
DEPARTMENT OF DEFENSE

by

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SMALL BUSINESS ASSISTANCE PROGRAMS
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BY

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CHAPTER I

INTRODUCTION

General

Small business is an institution that has long been in the national spotlight. It ranks close to motherhood and apple pie as standing for what is good in America. Or in the words of one writer, "One of the most sacred of the current sacred cows on the national political scene is that segment of the American enterprise termed 'small business'."¹

The concept of "small business" is difficult to define. The Small Business Administration, whose entire mission is to assist the small businessman, has itself several definitions, the exact definition varying according to the type of assistance (financial, procurement, etc.) given. For the time being, small business shall be defined for our purposes as one that is independently owned, not dominant in its field of endeavor, and employs a small (500 to 1,000) number of people.

Over the years the government has developed many ways of looking out for the small businessman. It has set up agencies designed specifically to help him; it has made financial assistance available to him; it has studied his problems and echoed these in legislation offering solutions. It has also used the government contract to assist him, i.e., it has made it possible for him to be given preference when government contracts are awarded. It is this process of contractual assistance which this paper studies.

¹Arthur Miller, "Government Contracts and Social Control: a Preliminary Inquiry," 41 Va. L. Rev. 27 (1955).

Statement of the Problem

The mission of the Department of Defense is to provide for the defense of the nation. This it is charged by Congress to do in an economic and effective manner. Therefore, one of its primary objectives is to buy all the material and services it requires to fulfill its mission competitively and wisely. This, the objective of all purchasing units everywhere, means buying the right combination of price, quality, and service.¹ The Armed Services Procurement Regulation states this objective in this manner:

Competitive proposals shall be solicited from such qualified sources of supplies and services as are deemed necessary by the contracting officer to assure such full and free competition as is consistent with the procurement of types of supplies and services necessary to meet the requirements of the Military department concerned, and thereby to obtain for the government the most advantageous contract--prices, quality and other factors considered.²

The emphasis placed on this, like all government objectives, can best be measured by the amount and level of public criticism the Department of Defense receives regarding its fulfillment. Congress, especially vociferous Senators and the General Accounting Office, all too frequently point out to the Department of Defense its failure to buy competitively and wisely. This objective, then, is one that is important to the Department of Defense and one that it continually strives to meet.

Other objectives of the Department of Defense in its procurement of requirements for national defense are socio-economic in nature. That is, rather than being concerned with the main thrust of the government contract (buying an item or service), they are concerned with the socio-economic effect of who receives it. An important one of these objectives is to assist the

¹Lamar Lee, Jr. and Donald W. Debler, Purchasing and Materials Management (New York: McGraw Hill Book Co., 1965), pp. 11-12.

²U.S., Department of Defense, Armed Services Procurement Regulation (1969 ed.; Washington, D.C.: Government Printing Office, 1969) para. 1-302.2.

small businessman by awarding defense contracts to him. This objective, too, has its roots in Congress, who for years has been expounding the virtues of the small businessman because of his economic importance to this country. The small businessman has also become important to the Department of Defense as a producer and supplier of goods and services.

Here, then, are two important Department of Defense objectives: to buy competitively and wisely and to assist the small businessman. However, that it can simultaneously implement both of these objectives is questionable. The Armed Services Procurement Regulation contains all of the policies and procedures the contracting officer must follow in order to meet the stated purchasing objectives in fulfilling the material requirements of the Department of Defense. In conjunction with the Small Business Administration and based upon the statutory requirements of Congress, the Department of Defense sets forth the policies and procedures governing awards to small business in Part 7 of this regulation. However, a close look at Part 7 reveals that these procedures and the policies behind them sometimes conflict with the objective of buying competitively and wisely. Likewise, the implementation of these procedures (the paperwork, the additional time required, etc.) sometimes conflicts with the responsibility of the Department of Defense, itself, to operate in an effective and economic manner. In real life, when faced with these two conflicting interests, which does the Department of Defense tend to subordinate, obtaining needed material at the right price and quality or assisting the small businessman? Inevitably the latter. /

If some would question this preference for one objective over another, just as many would question the second objective of assisting the

small businessman in general. One Department of Defense official¹ in testimony before a Congressional committee, for example, stated that the Department of Defense was doing a disservice to the small businessman when it gave him a prime government contract.² That is, if a small businessman receives a contract that eventually must be terminated because he lacked the necessary facilities, the management capability, or the staff required to interpret the mass of government communications, the government did not assist him at all, but rather did him a disservice.

Herein lies the problem. The agency that is able to provide the assistance (the award of the contract) has another purchasing objective that takes precedence over the objective to assist the small businessman. Additionally, the prime contract could, instead of assisting the small businessman, be a disservice to him. Considering this, perhaps the overall effectiveness of the assistance programs should be questioned. That is the purpose of this paper. The basic research question is: "How effective is the defense contract in providing assistance to the small businessman?" To provide a systematic and orderly approach to the attempt to answer this, five subsidiary questions were developed:

1. What is the origin of the underlying policy of assistance to the small businessman?
2. What methods are used by the Department of Defense in trying to fulfill this policy?
3. What are the benefits and limitations of these methods?

¹Mr. Gordon W. Rule, Director, Procurement Control and Clearance, Navy Material Command Headquarters, Washington, D.C.

²U.S., Congress, Joint Economic Committee, Economy in Government, Hearings before the subcommittee on Economy in Government of the Joint Economic Committee, Congress of the United States, 91st Cong., 1st sess., 1970, p. 170.

4. What methods or combination of methods best fulfill the underlying policy?

5. What ways are available to increase the effectiveness of the small business assistance programs?

Scope of the Paper

There are many ways the government assists the small businessman. The Small Business Administration offers some twelve different assistance programs. The scope of this paper, however, will be restricted just to the contractual assistance programs, i.e., those four major programs designed to help the small businessman obtain government prime and/or subcontracts. The paper will also limit its discussion only to Department of Defense programs and procurements, i.e., no other government agency procurements will be considered. There are two reasons for this. First, the Department of Defense is the largest single purchaser of goods and services in the world.¹ Second, it collects large amounts of data on its procurement which is published periodically. These reports and the Department of Defense's frequent testimony before Congress provide a readily available source of information on which to base a study of the share of procurements the small businessman receives.

There are several programs through which a small businessman can receive a government contract. (Chapter III examines each of these separately.) However, it would be quite difficult, if not impossible, to analyze the effectiveness of each procedure. In terms of the statistical data collected by the Department of Defense, the programs overlap and are not completely separable. Since the benefits and limitations of one program

¹U.S., Congress, House, Select Committee on Small Business, The Position of Small Business in Government Procurement, H. Rept. 1975, 90th Cong., 2d sess., 1953, p. 2.

may also generally apply to the others, a better criterion for grouping the programs for this study would be by level, i.e., whether they are for prime or subcontracts. Therefore Chapter IV and V analyzes all of the prime contract assistance programs together and all of the subcontract assistance programs together.

Research Methods Utilized

The research for this paper was for the most part secondary in nature. Specifically, a great deal of the information was found within the great wealth of testimony and reports published by the Congressional Small Business Committees, who, although they are not of a permanent nature, study and hear testimony in each Congress on small business problems. Other major secondary information sources were the Armed Services Procurement Regulation and other of the Defense Department's numerous publications describing the manner in which it spends its procurement dollar. Providing information to supplement these major secondary sources were several interviews with Department of Defense and Small Business Administration employees as well as other more general periodicals and texts on management and government procurement.

Primary research in the form of analyses, first of the statistical data provided by the Department of Defense on its small business procurements and secondly of the small business default rate were also important to the conclusions reached in this paper. With these exceptions, however, the research herein was entirely secondary.

Organization of the Paper

It would be easy to simply accept the statement that the government should assist the small businessman. However, there are many valid reasons why the government does. The first part of Chapter II--"The History of the Government's Assistance to the Small Businessman"--explores the economic

importance of the small businessman. With the reasons for assisting the small businessman well established, the discussion then turns to how the government has reacted to provide the needed assistance. The last half of Chapter II discusses the various organizations that have been created by Congress over the years to assist small business.

During the evolution of the present small business assistance organization, many policies were developed. The first part of Chapter III--"The Small Business Assistance Programs"--examines these policies of Congress and the Department of Defense. The second part of Chapter III explains how the Department of Defense is organized to carry out the small business assistance programs. Finally, the last part of the chapter examines in detail the specific contractual techniques employed by the Department of Defense to guide contracts toward the small businessman. As part of the discussion of each technique, special attention is given to the success of small business in obtaining government contracts.

The performance of small business in the field of government procurement, once illustrated, is preparation for the next chapter--"The Effectiveness of the Assistance Programs"--which evaluates the benefits and limitations of the programs. In this discussion several viewpoints must be considered, since a different evaluation can result from each. In the first part of the chapter the programs are evaluated from the viewpoint of the Small Business Administration. In the second part of the chapter the programs are evaluated from the viewpoint of the Department of Defense. Finally, the programs are discussed from the viewpoint of the small businessman.

It is the purpose of the final chapter of this paper first to briefly summarize the programs and their benefits and limitations and then, based on these evaluations, to answer the basic research question--How effective

is the defense contract in providing assistance to the small businessman?

The last part of Chapter V goes on to make, based on the findings of the paper, recommendations for improving the programs.

CHAPTER II

THE HISTORY OF THE GOVERNMENT'S ASSISTANCE TO SMALL BUSINESS

Introduction

The government's past and continued concern for the small businessman is an easily recognizable phenomenon. Congress has demonstrated this concern by establishing Select Committees each year to study the problems of small business, by creating agencies whose sole purpose is to assist the small businessman, and by emphasizing the importance of small business in numerous pieces of legislation.¹ The purpose of the first part of this chapter is to identify the reasons for the government's interest in small business.

The present policies of the government toward the small businessman were born in the 1930's, when the government contract was first used to further socio-economic causes. The various agencies Congress created to assist small business during World War II, during the Korean Conflict, and in the years that followed all played a role in developing the policies in effect today. The second part of this chapter, then, will trace the evolution of these present-day policies by examining the agencies which have been created through the years to fulfill the Congressional policy of assisting the small businessman.

¹A partial list includes the Defense Production Act of 1950, the Armed Services Procurement Act, the Federal Property and Administrative Services Act, the National Aeronautics and Space Act, and the Communications Satellite Act.

The Economic Importance of the Small Businessmen

The growth of the United States from thirteen colonies to a world power is also the story of the growth of American industry to a position of the greatest manufacturing nation in the world.¹ At least part of this dramatic development can be attributed to the fact that the economic basis of our nation is a system which encourages privately owned and operated businesses. To this extent, the role small business has played in the success story of our nation is an important one. Traditionally, small business sharpens competition; it disperses economic power; it helps to increase the efficiency of industry; it provides a source for new and better products; and it represents an economic opportunity to the individual American.

One important effect of small business on our economy is that it stimulates competition. The importance of this is stated clearly in the Small Business Act:

The essence of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business and opportunities for expression and growth of personal initiative and individual judgement be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this Nation. Such security and well-being cannot be realized unless the actual potential capacity of small business is encouraged and developed.²

How does small business act to increase competition and thereby stimulate the economy? When many firms are allowed to compete in the same market, two things usually happen: prices are lowered and quality is improved. One effect of many firms fighting for a limited market is that supply will exceed demand. When this happens economists tell us that prices will drop until

¹W.R. Sprigal, Industrial Management (New York: John Wiley & Sons, Inc., 1953), p. 5.

²Small Business Act, 15 U.S.C. 631.

the market is in equilibrium¹, that is, until supply once again equals demand. Another effect is that one firm will eventually, rather than lower his price, come out with a product better than the rest. If he can differentiate his product for even a short while, he will be in the enviable position of being the sole supplier and/or possibly the biggest profit maker. The consequence of his better product over the long run, however, will be that competition will copy or come out with a product of like quality, and the market will eventually again be in equilibrium.² Prices thus kept at a minimum and quality at a maximum is the ideal of a sound economy. To this extent, small business is indeed important for the well being of our nation.

Another effect of small business is that it tends to disperse the economic power of U.S. industry. Indeed, there is a tendency in our country toward a concentration of economic power in the hands of only a few companies. As shown on Table 1, only 2.6% of the companies in the United States accounted for 77.4% of the receipts (sales) in 1967.

TABLE 1

NUMBER AND BUSINESS RECEIPTS OF U.S. BUSINESSES FOR 1967^a

| Size of Receipts (dollars) | Number of Companies (000) | Total Receipts (\$000,000) | Percent of Total Number | Percent of Total Receipts |
|----------------------------|---------------------------|----------------------------|-------------------------|---------------------------|
| Under 10,000 | 6,136 | 18,593 | 53.0 | 1.2 |
| 10,000-25,000 | 1,989 | 31,343 | 17.2 | 2.0 |
| 25,000-50,000 | 1,232 | 42,483 | 10.7 | 2.7 |
| 50,000-100,000 | 921 | 63,188 | 8.0 | 4.0 |
| 100,000-500,000 | 985 | 200,639 | 8.5 | 12.7 |
| Over 500,000 | 303 | 1,218,149 | 2.6 | 77.4 |

^aSource: U.S. Bureau of the Census, Statistical Abstract of the United States: 1970, (91st ed.; Washington, D.C.: Government Printing Office, 1970) p. 470.

¹Donald S. Watson, Price Theory and Its Uses (2nd. ed.; Boston, Mass: Houghton Mifflin Company, 1968), p. 239.

²Ibid., pp. 257-258.

An even more dramatic illustration of the tendency toward concentration of economic power in the United States is Table 2, which shows for 1969 the amount of assets owned, the number of personnel employed by, and the net income of the largest 500 companies in the United States.

TABLE 2
ASSETS AND EMPLOYEES OF THE TOP 500 COMPANIES FOR 1969^a

| SIZE RANKING | ASSETS | | EMPLOYEES | | NET INCOME | |
|-----------------|-----------------------|---------------|-----------------|---------------|-----------------------|---------------|
| | Amount (\$000,000) | % of Total | Number (000) | % of Total | Amount (\$000,000) | % of Total |
| 1 - 100 | 260,730 | 64.9 | 8,894 | 60.0 | 16,275 | 65.9 |
| 101 - 200 | 69,673 | 17.3 | 2,736 | 18.4 | 4,224 | 17.1 |
| 201 - 300 | 35,585 | 8.9 | 1,452 | 9.8 | 1,946 | 7.9 |
| 301 - 400 | 20,955 | 5.3 | 1,040 | 7.0 | 1,252 | 5.1 |
| 401 - 500 | 14,649 | 3.6 | 692 | 4.7 | 982 | 4.0 |

^aSource: U.S. Bureau of Census, Statistical Abstract of the United States: 1970, (91st ed.; Washington, D.C.: Government Printing Office, 1970), pp. 477-478.

A quick comparison between the top 100 companies and the companies ranked from 401 to 500 shows that the top 100 companies' assets were almost 18 times as large, the number of people they employed was 13 times as many, and their net income was 16 times as great. Considering that altogether there were over 11,000,000 businesses in the United States in 1967¹, that indicates a tremendous concentration of economic power in the hands of relatively few. Likewise, the large corporation dominates the government procurement market.

Eighty percent of the value of all purchases made by the Department

¹U.S., Congress, House, Select Committee on Small Business, Position of Small Business in Government Procurement, H. Rept. 1975, p. 2.

of Defense are placed with large corporations.¹ In fact, in 1970 the five top contractors received a larger share of the defense dollar than all of the small business firms doing business with the Department of Defense put together.² The top Department of Defense contractor, Lockheed Aircraft Corporation, alone received a bigger percentage (5.9%) of the total awards than were specifically set aside for small business (4.2%).³ That concentration is generally undesirable and that the government should do everything in its power rather to keep economic power dispersed has been and continues to be the cry of many in this country. Franklin D. Roosevelt stated in his message to Congress requesting Anti-trust legislation:

Among us today a concentration of private power without equal in history is growing.

This concentration is seriously impairing the economic effectiveness of private enterprise as a way of providing employment for labor and capital and as a way of assuring a more equitable distribution of income and earnings among the people of the Nation as a whole.⁴

One means the government has to assure the dispersion of economic power is through regulation such as Roosevelt was advocating. The other means is by assisting the small to get a fair share.

Small business also affects the efficiency of U.S. industry in general. The very nature of small business demands specialization, constitutes decentralization, and assures flexibility, all three factors which contribute to greater efficiency.

Because of their size, most small businesses can perform only one or

¹U.S., Department of Defense, Military Prime Contract Awards and Subcontract Payments or Commitments: July 1969-June 1970, (Washington, D.C.: Government Printing Office, 1970), p. 13.

²U.S., Department of Defense, Military Prime Contract Awards, p. 13; and U.S., Department of Defense, 100 Companies: Fiscal Year 1970 (Washington, D.C.: Government Printing Office, 1970), p. 1.

³Ibid.

⁴U.S., Congress, Senate, 75th Cong., 2nd sess., April 29, 1938, Congressional Record, LXXXIV, 5992.

two tasks. It is a well known management concept that out of specialization of tasks evolves efficiency of operation¹; just as specialization of tasks improves the efficiency of one man's efforts, so specialization of operations improves the efficiency of organizations, and specialization of one firm improves the efficiency of an industry. Such is the impact of small business.

Likewise, many widely dispersed small businesses constitute the kind of decentralization of management that many large corporations strive for today. Decentralization fosters efficiency, or in the words of two management authorities:

Decentralization of authority has so grown in recent years that the management that does not subscribe to it may appear outmoded. This development is understandable, because if enterprise efficiency lies in the coordination of people, it is logical that those responsible for this coordination should have requisite authority to manage and that this authority, in turn, should suitably be pushed down into the organization.²

And, the capability small business naturally has for flexibility further serves to improve the efficiency of U.S. industry as a whole. Without the necessity for formalized rules and a need for a highly coordinated approach, the small businessman is much more flexible in his response to a situation. This flexibility and speed of reaction helps to improve the overall efficiency of the industry.

Small business is also important to the American economy as a source of new products. In his fight for survival, the small businessman is often more innovative than the large corporation which can afford to sit back and rest on its laurels. As John E. Horne, Chairman of a White House Committee on Small Business stated:

¹Specialization is not a new concept. It was originally pointed out by Henri Fayol in his book, General and Industrial Administration written in 1916. He defined specialization as the "division of work to produce more and better work with the same effort."

²Harold Koontz and Cyril O'Donnell, Principles of Management (4th ed.; New York: McGraw Hill Book Company, 1968); p. 375.

There is no indication that economic concentration, large resources, long experience, or an abundance of trained personnel lead necessarily to technical progressiveness. Indeed, there are many authoritative voices and much statistical evidence to the contrary. A former vice president of General Electric, in charge of the appliance division, wrote that "original inventions are no more plentiful, proportionately, in big than in small organizations." He argues, for example, that "in the electrical appliance industry, the better clothes-washing machines have not been produced by the monster companies but by the relatively small independent companies specializing in one or two products. This is also true of ranges, vacuum cleaners, radios . . . etc." In his opinion, the prospects for technical progress are greater where the centers of initiative are diffused, where thousands of individuals and organizations have the incentive to work and think for the future.¹

Finally the small business is important to the nation because it provides the opportunity for individuals to fulfill the "American Dream", that is, to own one's own business. This opportunity for self realization and expression has played an important role in the development of the industry of the United States.²

The small businessman is, then, of great economic importance to the United States. His being given the opportunity to compete with the large has important ramifications not only for the government, but for all of industry and every American as well.

Legislative History

During the 1930's when the United States was struggling to recover from the great economic depression, Congress began to show interest in and passed into law many socio-economic assistance programs. From one of these programs was born one of the first agencies to assist the small businessman, the Reconstruction Finance Corporation. Created by Congress in January, 1932, its primary function was to make loans to businessmen, large and small. Hence, the beginning of the Federal Government's assistance to the small

¹White House Committee on Small Business, Why Help Small Business? by John E. Horne, Chairman, a mimeographed undated report, p. 15.

²Ibid., p. 4.

businessman.

During this same time period (1930's) the Supreme Court chose to follow a narrow interpretation of the Constitution and struck down a large portion of the New Deal legislation. The Executive and Legislative branches, feeling their power somewhat constricted, searched for other means to effect their social and economic programs. They embraced the idea of the government contract. Contractually enforced minimum wage laws, preferences for U.S. made material and U.S. firms, prohibitions of child and convict labor, etc., all originated in this period. Logically the idea of using the government contract to assist the small businessman would also gain momentum.

Although Congress did not take any further actions in the 30's to formally assist the small businessman in his effort to obtain government contracts, it was quick to act when World War II started. It wanted to ensure that the small businessman was not overlooked in the rush to mobilize the industry of the United States. Therefore, on July 11, 1942, it passed Public Law 77-603 and created the Smaller War Plants Corporation. This was the first agency specifically created to assist the small businessman and out of it evolved many of today's small business procurement policies and programs. One of its primary functions was to assist the small businessman in obtaining prime government contracts and subcontracts from prime contractors. It also established and maintained an inventory of small business production facilities. This inventory was used by government buying agencies and prime contractors in locating small business sources for products they needed. The Smaller War Plants Corporation also had the capability to actually make subcontracts with small business firms. The buying agency would contract with the Smaller War Plants Corporation for a required item, and then the Smaller War Plants Corporation would award a subcontract to a small business. It was then in a position to provide more

assistance to the small businessmen than if the small business had contracted directly with the government. Finally, when the small businessman needed financial assistance, the Smaller War Plants Corporation was able to make loans to him.

X During its existence from 1942 to 1945, the Smaller War Plants Corporation had an enviable record of performance. Table 3 reflects the number of awards that it assisted the small businessman in obtaining.

TABLE 3

SMALLER WAR PLANTS CORPORATION
(November 1942 - November 1945)^a

| Contracts Awarded Small Business | Number | Amount (\$000,000) |
|-------------------------------------|--------|-----------------------|
| PRIME CONTRACTS | 58,385 | 5,700.0 |
| SUBCONTRACTS from Prime Contractors | 52,000 | 30.6 |
| SUBCONTRACTS from the SWPC | 12 | 35.5 |

^a Source: Addison W. Parris, The Small Business Administration (New York: Fredrick A. Praeger Co., 1968), p. 18.

The Smaller War Plants Corporation was disestablished by Executive Order soon after the end of World War II. However, its functions were not abolished, but rather were transferred to other permanent agencies. The lending and prime contract assistance functions were transferred to the Reconstruction Finance Corporation. The remaining functions and people were moved to the Office of Small Business, Department of Commerce. But, the Office of Small Business with its few functions ended up doing little but produce forecasts and provide information to the small businessmen.

At the onset of the Korean Conflict, Congress again recognized the need for a specific agency to assist the small businessman. In recognition of the assistance rendered to small firms during World War II by the Smaller

War Plants Corporation, Congress decided to create a similar agency. In July of 1951, as an amendment to the Defense Production Act of 1950, it created the Small Defense Plants Administration. Again it was the responsibility of this agency to aid the small businessman in his attempts to obtain government contracts. Like its forerunner, the Small Defense Plants Administration not only provided counseling and information services to the small businessman, but also had the capability to actually subcontract work to him. One new assistance capability that Congress provided the Small Defense Plants Administration, was the ability to make competency determinations, that is, to certify that a small business firm had the capability to complete a contract. This determination was issued in the form of a "Certificate of Competency" to the government buying agency. The Certificate of Competency or COC was binding on the contracting officer, that is, the small businessman's bid could not be disqualified because the contracting officer questioned the capability or capacity of his firm to complete the contract. A competency review was usually made only on firms that were low bidders on a contract and therefore often meant a savings to the government if the firm was determined to have the capability and then was awarded the contract. During the two years that the Small Defense Plants Administration was in existence, it issued 125 Certificates of Competency. The savings that resulted from these actions amounted to over \$5 million.¹ However, as shown on Table 4, the Small Defense Plants Administration's overall performance was substantially less than the Smaller War Plants Corporation. The primary reason for this poor performance was that the Small Defense Plants Administration had no direct voice in the awarding of

¹Ibid., p. 19.

government contracts.¹ It acted only as an advisor to the contracting officer and had no route of appeal if the contracting officer decided not to follow its advice.

TABLE 4

SMALL DEFENSE PLANTS ADMINISTRATION
(July 1951 - July 1953)^a

| Contracts Awarded Small Business | Number | Amount (\$000,000) |
|-------------------------------------|--------|-----------------------|
| PRIME CONTRACTS | 2,197 | 591 |
| SUBCONTRACTS from Prime Contractors | 759 | 19 |
| SUBCONTRACTS from the SDPA | 7 | 2 |

^aSource: Small Defense Plants Administration, Seventh Quarterly Report of the Small Defense Plants Administration (Washington, D.C.: Government Printing Office, 1953), p.2.

By 1953 the defense requirements of the Korean War had been met to the point where the nation started moving in the direction of a peace time economy. However, this time Congress felt that there was a continuing need even during peace time for a separate agency within the government to carry out its policy of assisting the small businessman. Therefore, on July 30, 1953 it passed the Small Business Act and created the Small Business Administration, a new government agency whose purpose was, according to its basic charter, to assist and protect the interests of the small businessman and ensure that he gets a fair proportion of government contracts.² The act abolished the Small Defense Plants Administration as well as the Reconstruction Finance Corporation and provided for the assumption of most of these organizations' functions by the Small Business

¹Ibid.

²Small Business Act, 15 U.S.C. 631.

Administration.¹

In 1958 Congress passed P.L. 85-536, an amendment to the Small Business Act, and added substantially to the original small business legislation. The paramount feature of this new legislation was that it recognized the Small Business Administration as a permanent agency of the Federal Government. Additionally, Congress clearly accepted independent small business enterprise as a distinct and vital element of the national economy.² Overall, the stature and responsibility of the Small Business Administration was substantially increased.

In these acts and a less significant amendment in 1961 that established a subcontracting program, the Small Business Administration was given a wide range of functions. These functions fall into three broad categories of assistance: financial assistance, management assistance, and procurement assistance.

The financial program consists of making and guaranteeing loans to small businessmen for expansion, acquisition of fixed assets, or working capital. Special loans are available to provide capital for low income or disadvantaged persons to start a business; others help small businessmen recover from the effects of natural disasters.

In the area of management assistance, the Small Business Administration operates two well known counseling and information services called CALL (Counseling at the Local Level) and SCORE (Service Corps of Retired Executives). It also sponsors many administrative management courses, one day conferences, workshops and clinics. And, it publishes a large number

¹Gerald R. Rosen, "Agency that Helps Small Business," Duns Review and Modern Industry, November, 1964, pp. 48-49.

²U.S., Congress, Senate, Select Committee on Small Business, Small Business Programs, Policies, and Procedures of Government Agencies, S. Report 2505, 85th Cong., 2d sess., 1958, p. 26.

and wide variety of pamphlets, books, and other publications designed to assist the small businessman.

It is their procurement program that is significant to the subject at hand, and the Small Business Administration offers quite a bit of assistance in this area. It maintains almost eighty field offices in the major cities across the United States to advise small businessmen on prime and subcontracting opportunities. Small Business Administration procurement specialists assist the small businessman in having his name placed on bidders lists, in obtaining specifications and drawings, and, in general, by acting as a helpful interface between the buyer and the seller. The Small Business Administration also gives advice and assistance through their many procurement related publications. Publications such as "The U.S. Government Purchasing and Sales Directory" and "Selling to the Government" are provided either free or at a nominal cost.

The Small Business Administration also takes an active role in obtaining government contracts for the small businessman. Like its forerunner, it has the capability to issue "Certificates of Competency". Likewise, in a cooperative effort with the government buying agencies and local business groups, it participates in many "Contract Opportunity Meetings". In these meetings, small firms learn of prime and subcontract opportunities when the government and prime contractors present their needs and requirements and discuss bidding opportunities. The Small Business Administration also helps government and prime contractors locate additional small business suppliers. It maintains an inventory of small business production facilities and is continually trying to expand it.

Finally, in cooperation with the Department of Defense, the Small Business Administration has developed four formal programs to direct prime and subcontracts to the small businessman. These programs, the Section 8(a)

contract program, the subcontracting program, the set-aside program, and the assistance measures given when small business competes with large are the subject of the next chapter.

Summary

As in the past, the small businessman continues to play a significant role in the economic development and well being of our country. Indeed, he has a vitalizing effect on the market. He helps keep prices down, quality up, and competition keen. His being in the market helps disperse economic power without resorting strictly to government regulation. He increases the efficiency of industry because he is inherently decentralized, usually specialized, and naturally flexible. He is also a source of new and better products, since he must be innovative in order to survive. Finally, he is a symbol of the "American dream", the epitome of what opportunity means to the individual American. Surely he is worthy of assistance in the economic ring.

Providing assistance to the small businessman is not a new idea. It had its beginning when the country first became "social welfare" conscious, that is, soon after the depression. The first kind of assistance the government offered was financial; it set up a loan agency called the Reconstruction Finance Corporation. During World War II and then again during the Korean Conflict, in the government's efforts each time to increase the mobilization base, organizations (The Smaller War Plants Corporation from 1942 to 1945 and the Small Defense Plants Administration from 1951 to 1953) were formed to help the small businessman get some of the many government contracts for war materials. Because these organizations were successful in their mission, it was decided in 1953 that an organization of this kind might also be valuable in a peacetime economy. The Small Business

Administration which was created by the Small Business Act of 1953 assumed the financial function of the Reconstruction Finance Corporation and the procurement assistance functions of the Small Defense Plants Administration. Today it provides assistance of many kinds, but it is the many forms of procurement assistance that is of significance to this paper, particularly the programs that have been developed in conjunction with the Department of Defense. The next chapter will discuss these programs.

CHAPTER III

THE SMALL BUSINESS ASSISTANCE PROGRAMS

Introduction

In an effort to trace the evolution of the government's policy of assistance to small business, Chapter II examined chronologically the various organizations created over the years for this purpose and, more specifically, the functions of these organizations. It now seems appropriate to take a closer look at the present day policy and the way the Department of Defense is organized for implementing this policy. The remainder of this paper will consider small business assistance as it is available in the form of various programs within the Department of Defense. The purpose of this chapter, then, is first to examine the stated small business assistance policies of the Congressional and Executive branches of our government; secondly, to describe briefly the organizational approach within the Department of Defense for implementing these policies; and finally, to examine in depth each of the assistance programs available. In pursuing the last, emphasis will be placed on the specific procedures followed by the Department of Defense as well as the performance or end results of each of these programs.

Policies Behind the Programs

Through the years Congress has expressed its policy toward the small businessman many times and in many ways. In the words of a recent Congressional report, "The Congress has repeatedly declared the need to

preserve and strengthen small business in order to preserve our free economic enterprise system" and " government procurement is specifically designated . . . as a major area in which small business is to be assisted, protected, and afforded the opportunity to participate equitably."¹ Members of the Small Business Committee traditionally express their view of what the Congress' policy toward the small businessman should be at the opening of hearings. Congressman Broyhill of North Carolina once stated,

The Congress, in its mandate contained in the Small Business Act, directs that all Government agencies must aid, assist, counsel and protect small business and see to it that a fair proportion of purchases including subcontracts be placed--and I emphasize--placed---with small business.

Through such effort our Government can best assure that small business can and will remain vigorous. Through such efforts, we can assure the maintenance and growth of this segment of our economy so vital to our economic health and military defense.

Simultaneously, we can best assure that the Government in its procurement gets the most for its dollar, for it has been proven that small business generally provides the greatest efficiency, the flexibility and the creativity required.

Therefore, it is to see that Government does obtain the most of the beneficial contributions of small business and that small business provides the full measure of its capability that commands our efforts today.²

However, the most explicit statement of the intent of Congress is in the Small Business Act. It states:

It is the declared policy of the Congress that the government should aid, counsel, assist and protect, insofar as is possible, the interests of small business concerns in order to preserve free competitive enterprise, to insure that a fair proportion of the total purchases and contracts or subcontracts for property and services for the Government (including, but not limited to contracts or subcontracts for maintenance,

¹U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement--Before and After Defense Cutbacks, H. Rept. 91-1608, 91st Cong., 2d sess., 1970, p. 1.

²U.S., Congress, House, Select Committee on Small Business, Small Business Subcontracting and Set-Aside Programs, Hearings before the subcommittee on Government Procurement and Economic Concentration of the Select Committee on Small Business, House of Representatives, pursuant to H.R. 53, 90th Cong., 1st and 2d sess., 1968, p. 4.

repair and construction) be placed with small business enterprises, to ensure that a fair proportion of total sales of Government property be made to such enterprises, and to maintain and strengthen the overall economy of the Nation.¹

It is, then, the specifically stated and oft repeated policy of the Congress of the United States to actively assist the small businessman.

The stated general policies of the Department of Defense vary little from with those expressed by Congress. The Armed Services Procurement Regulation states:

It is the policy of the Department of Defense to place a fair proportion of its total purchases and contracts for supplies, research and development, and services (including but not limited to contracts for maintenance, repairs and construction) with small business concerns. Every effort should be made to encourage participation by such concerns in the procurement of supplies and services that are within their capabilities. Heads of Procuring Activities and heads of field purchasing and contract administration activities are responsible for the effective implementation of the Small Business Program within their respective activities. Procurement and technical personnel attached to such activities shall be informed of the benefits that accrue to the Nation and the Department of Defense through the proper use of the capabilities of small business concerns in the procurement of military requirements.²

This general Department of Defense policy has been amplified many times before Congressional committees. For instance, John M. Malloy, Deputy Assistant Secretary of Defense, Installations and Logistics, in testimony before a subcommittee of the House Committee on Government Operations on October 17, 1969, stated that:

We [the Department of Defense] have a policy that flows from and implements the Small Business Act. The Policy has as its philosophy, as stated in that act, that a fair proportion of Defense purchases will awarded to small business concerns.³

¹Small Business Act, 15 U.S.C. 631.

²U.S., Department of Defense, Armed Services Procurement Regulation, para. 1-702 (a).

³U.S., Congress, House, Committee on Government Operations, To Establish a Commission on Government Procurement, Hearings before a subcommittee of the Committee on Government Operations, House of Representatives, pursuant to H.R. 474, 91st Cong., 1st sess., 1969, p. 20.

As to what, according to its general policy, the Department of Defense considers a "fair share" he elaborated further, stating,

A fair share is hard to quantify. I would say the objective is to provide methods whereby small business concerns are provided an equitable opportunity to compete for our business. We make known to them the things we are buying. We help them by instructing them on how we do our business. In addition, we have adopted special programs designed to carry out the intent of that law.

In order to see that the general policies are implemented, the Department of Defense defines in the Armed Services Procurement Regulation its specific policies regarding small business. They are:

1. To seek out new small business sources.
2. To give wide publicity both to the manner in which the Defense Department buys and to all proposed procurements.
3. To include all established and qualified small businesses on all bidders lists.
4. To actively solicit proposals from small firms.
5. To, where practical, divide procurements among large and small business.
6. To allow small business maximum time practicable for submitting bids.
7. To establish delivery schedules that will encourage small business participation.
8. To encourage subcontracting to small business by large prime contractors.
9. To use small business as planned producers in the Industrial Readiness Planning Program (a mobilization program).
10. To maintain liaison with other government agencies and public and

¹Ibid.

private organizations in order to provide information and assistance to small business.¹

The Department of Defense, then, in undertaking to fulfill the intent of Congress has developed policies, both general and specific, which clearly are intended to assure real assistance for the small businessman when it comes to government procurements.

Organization Within the Department of Defense for Small Business Assistance

Considering the size and scope of the Department of Defense's programs of assistance to small business, its organizational approach for implementing this assistance is quite simple. In general, Department of Defense personnel assigned to this function are staff advisors; at the headquarters level they are part of Department Secretaries' staffs; in the field they are on the staffs of the Heads of Procuring Activities.

The Director for Small Business within the Department of Defense is on the staff of the Assistant Secretary of Defense (Installations and Logistics). He is responsible for advising the Assistant Secretary on matters relating to the establishment, implementation, and execution of the Defense Department's small business programs. He also acts as the Department's representative in discussions with the Small Business Administration and other government agencies regarding small business policy.²

To implement the policies and programs at the department level, each military department and the Defense Supply Agency maintains an Office of Small Business. The Chiefs of each of these offices has responsibilities similar to the Director of Small Business for the Department of Defense,

¹U.S., Department of Defense, Armed Services Procurement Regulation, para. 1-702 (b).

²Ibid., para. 1-704. i.

except that the scope of their duties and authority is limited to the department to which they are attached. That is, they act as advisors to either the Secretaries of the Army, Navy and Air Force or the Director of the Defense Supply Agency and represent their particular organization in policy discussions.¹

In the field, that is, at each of the principle buying activities and contract administration offices throughout the Department of Defense, there is a small business specialist appointed to implement the small business program. He is employed by the Defense Department and usually works directly for the Head of the Procuring Activity.² He is not, therefore, subject to the direction or control of an activity's contracting or technical personnel.³ The small business specialist is assigned a variety of functions, more specifically:

1. To locate capable small business sources.
2. To coordinate the replies to small businessman's request for information and assistance.
3. To review all proposed procurements in excess of \$2,500 for possible restriction to small business sources.
4. To review procurement programs for possible breakout of items for which small business has capability.
5. To ensure that available financial assistance is offered.
6. To participate in prospective contractor responsibility

¹Ibid., para. 1-704.2.

²The Air Force is the major exception. Here, according to the Armed Services Procurement Regulation, para. 1-704.3 (a)(iii), he is assigned to the Director of Procurement and Production or a comparable person at each central purchasing activity and Major Air Command, the chief of each contract administration activity, or the Base Commander of a local purchasing activity.

³U.S., Department of Defense, Armed Services Procurement Regulation, para. 1-704.3 (a).

- determinations.
7. To evaluate prime contractors' subcontracting programs.
 8. To ensure that small business participation is accurately reported.¹

Within the Defense Department's organization, then, the key men to the effectiveness of small business assistance programs is really the small business specialist. Located at the level where contracts are actually awarded, he and his efforts toward assisting small business can and should show positive results.

Contractual Assistance Techniques

The Department of Defense has currently at its disposal four means--be they called procedures, programs, or techniques--of channeling contracts toward the small businessman. The development of these four techniques was the joint effort of the Department of Defense, the Small Business Administration, Congress and industry in general. Their administration and implementation, however, is primarily left in the hands of the Defense Department. Two of the four techniques are subcontracting programs; the others are programs for directing prime contracts to the small businessman.

Subcontract Programs

Section 8(a) Contracts

One subcontracting technique for assisting small business is the Section 8(a) contract. The Small Business Administration, like its predecessors, has the authority to enter into contracts with government procuring activities for supplies and services and then to subcontract the requirement to small businesses. This authority is derived from Section 8(a) of the Small Business Act, whence the contracts received their name.

¹Ibid., para. 1-704.3 (b).

The Small Business Act does not designate or restrict how these contracts are to be used; however, they are a logical choice for assisting the struggling new small business, the small business in the making, or the small business in areas of hardcore unemployment or concentrated minority settlement. This is because the government offers small firms that are awarded 8(a) contracts free management and technical aid in planning and operating their business. The official Department of Defense policy toward the 8(a) program therefore is:

to enter into contracts with the SBA to foster or assist in the establishment or the growth of small business concerns as designated by the SBA so that these concerns may be self-sustaining, competitive entities within a reasonable period of time.

The first step the small businessman or potential small businessman must make in an effort to receive a Section 8(a) contract is to submit to the Small Business Administration a written plan outlining his company's product, financial condition, management and technical capability and prospects for the future. If the plan meets its approval, the Small Business Administration submits it to the Office of the Assistant Secretary of Defense, (IBL) along with its proposal for supporting the plan, showing the following information:

1. The background and ownership of the firm.
2. How and when the firm is expected to become a self-sustaining entity.
3. The extent to which procurement assistance is needed and an identification of the requirements sought from the Department of Defense. . . and
4. If the firm is currently in existence, the present production capacity and related facilities and how any additional facilities needed will be provided.²

If the Director for Small Business in the Office of the Assistant Secretary of Defense approves the plan, an offer to supply the item or service is passed to the military departments. Each service reviews the proposal and

¹Ibid., para. 1-705.5 (b).

²Ibid.

decides to what extent it can support the requested commitments. The plan, along with any military department comments and the statements of potential commitments, are then returned to the Director for Small Business. He then notifies the Small Business Administration of the extent to which a contract or contracts will be placed with them. This notification represents a firm commitment on the part of the Department of Defense to acquire the items or services using a Section 8(a) contract. The Small Business Administration contacts the buying activity and negotiations between them for the item or service are started. When satisfactory terms and conditions have been negotiated and the contract has been approved at the military department headquarters level, the contracting officer awards the contract to the Small Business Administration. To assist the Small Business Administration in the award of the subcontract, the buying agency also prepares the subcontract.¹ The Section 8(a) contract procedure is thus completed. It is not overly complex or difficult, but it does require the review and approval of high level headquarters employees of the Department of Defense.

Although the Section 8(a) contract technique has been available for some time, little use is made of it. In the period between 1953 and 1968 only two Section 8(a) contracts were awarded.² Since 1968 there have been 41 contracts valued at approximately 20.8 million dollars awarded through this procedure.³

There are several reasons for this low use. First is the fact that

¹Ibid., para. 1-705.5.

²U.S., Congress, House, Committee on Government Operations, To Establish a Commission on Government Procurement, Hearings, p. 1558.

³U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement--Before and After Defense Cutbacks, Hearings before the subcommittee on Government Procurement of the Select Committee on Small Business, House of Representatives, pursuant to H.R. 66, 91st Cong., 2d sess., 1970, p. 352.

the Section 8(a) contract is directed towards and traditionally used to assist the newly developed, minority run, ghetto located small business¹, and this is something that has only recently become popular. Secondly, the product these kinds of small businesses are capable of producing for the government is generally only one that is easily producible and one that personnel can easily be trained to produce.² Also, the Small Business Administration feels the product should be one for which additional capacity is required so that the Section 8(a) contracts will not take contracts away from other small companies.³ Finding a requirement for this sort of product, even in a large organization like the Department of Defense, is quite difficult. A third and also important reason why the Section 8(a) program is rather neglected is that the Small Business Administration devotes very little of its resources to it; last year it had only five people (out of fifty assigned to the procurement function) assigned to the Section 8(a) program.⁴

As to the future of the Section 8(a) program, Mr. Clyde B. Bothmer, Deputy Associate Administrator, Office of Procurement and Management Assistance, Small Business Administration, has this to say:

We have proceeded so far on a very limited, almost pilot test basis, because we really do not have the resources to proceed on any wider scale and also because we thought it was wise to get some experience before we expanded the program. We are currently talking to other departments of the Government which are involved, as well as to the Administration generally as to the future of 8(a). If we get the proper go ahead to

¹Small Business Administration, "8(a) Contracting: How SBA Channels Government Purchases to Small Business," (pamphlet issued by the Office of Public Information, Small Business Administration), July, 1970, p. 3 and U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement, Hearings, p. 351.

²U.S., Congress, House, Committee on Government Operations, To Establish a Commission on Government Procurement, Hearings, p. 1558.

³Ibid.

⁴Ibid., p. 1560.

expand the program, we certainly will be happy to do so, Mr. Chairman.¹ Therefore, the future of the Section 8(a) contract is a question mark. Most likely it will continue to be used, but only on a limited basis to assist primarily developing and minority enterprises.

Subcontracting (by prime contractors) program

The second subcontracting assistance program is much more popular; so much so, that it is referred to by most as the subcontract program. Its purpose is to assure small business of a share in the business of supplying major prime contractors with the materials they need to perform prime government contracts. Or in the words of the Department of Defense, it is designed to:

enable small business concerns to be considered fairly as subcontractors to contractors performing work or rendering services as prime contractors or subcontractors under Government procurement contracts . . .²

This subcontract program has its origin in the 1961 amendment to the Small Business Act.³ This amendment required that major prime contracts (those over \$1 million) and major subcontracts (those over \$500,000) contain in them a provision requiring those holding these contracts to conform to some kind of small business subcontracting program.⁴ The exact details and standards these subcontracting programs were expected to meet the amendment left up to the Small Business Administration, the Department of Defense, and the General Services Administration to develop.

The program these agencies developed, that is, the present

¹Ibid., p. 1556.

²U.S., Department of Defense, Armed Services Procurement Regulation, para. 1-701.1 (a).

³Small Business Act, 15 U.S.C. 631.

⁴Ibid.

subcontract program, exceeds the statutory requirements of the amendment in three aspects. First, it makes the provision for a subcontracting program part of prime contracts over \$500,000, rather than just those over \$1 million. Secondly, a technique has been developed to help prime contractors find a small business source for items they require. The Small Business Administration maintains a capability file which prime contractors can check at any time. Finally, in contracts under \$500,000 (but over \$5,000) the contractor must agree to use his "best efforts" in placing subcontracts with small business.¹

The specific actions required by a prime contractor can be deduced from a small business subcontractor inspection guide in the Armed Services Procurement Regulation. They are:

1. To pursue a program designed to locate additional small business sources.
2. To attempt to place development type work that would result in production opportunities with small business.
3. To provide financial, engineering, technical, and managerial assistance to any small businessman to whom he subcontracts.
4. To attempt to "breakout" components of large systems so that a portion can be subcontracted to small business.
5. To participate in defense and industry conferences, open houses, and other meetings designed to increase the number of contracts with small businessmen.
6. To consider small business in "Make or buy" decisions.
7. To give small business an equal bid opportunity.

¹U.S., Department of Defense, Armed Services Procurement Regulation, para. 1-707.3 (a).

8. To maintain records of small business performance and submit them periodically to the Defense Department.¹

It is the contract itself which sees that the requirements for this program are enforced. All contracts over \$500,000 must contain a clause entitled "Small Business Subcontracting Program" in which the contractor agrees to set up a subcontracting program such as is outlined above. The contractor also agrees in this clause: 1) to appoint an administrator of his small business program who will also act as the liaison between his company and the government on small business matters; 2) to notify the government before asking for bids whenever he does not plan to or when he is incapable of soliciting a bid from small business; and 3) to use this same clause in all contracts he awards that have substantial subcontracting opportunities.²

This subcontract program is much more widely used than the Section 8(a) contract program. As Table 5 shows, in 1970 small business received over 35% of the dollar value of the contracts awarded by the 934 reporting prime contractors. Although Table 5 is an indication of the use that is made of this program, the exact amount of contracts small business receives as a result of it is unclear. This is because the number reporting on the program (934 in 1970) does not represent all who received prime contracts. Also, only contract awards to the first tier of subcontractors are traditionally reported. It can be safely assumed that of the 60% of the total awards that go to large business, small business also gets some proportion as a subcontractor to large subcontractors. Surely, then, if it were possible to record all of these awards as well as the awards made by non-reporting prime contractors, the small business share of the total would appear even larger.

¹Ibid. para. 1-707.4 (c).

²Ibid. para. 1-703.3 (b).

TABLE 5
SMALL BUSINESS SUBCONTRACTING PROGRAM^a

| CATEGORY | FISCAL YEAR | | | | | | | |
|---|-------------|-------|-------|--------|--------|--------|--------|--------|
| | 1963 | 1964 | 1965 | 1966 | 1967 | 1968 | 1969 | 1970 |
| Number of Contractors Reporting | 453 | 617 | 601 | 735 | 816 | 886 | 946 | 934 |
| Value of Subcontracts (\$000,000) | 11,411 | 9,278 | 8,518 | 12,163 | 15,472 | 15,225 | 14,883 | 11,931 |
| Value Awarded to Small Business (\$000,000) | 4,341 | 3,629 | 3,534 | 5,102 | 6,697 | 6,496 | 6,046 | 4,378 |
| Percent Awarded to Small Business | 38.0 | 39.1 | 41.5 | 41.9 | 43.3 | 42.7 | 40.6 | 36.7 |

^aSource: U.S., Department of Defense, Military Prime Contract Awards and Subcontract Payments or Commitments: July 1969-July 1970 (Washington, D.C.: Government Printing Office, 1970) p. 57.

Perhaps a better indication of the use made of this subcontract program would be to investigate how the program has been received and utilized in the hands of a large prime contractor and a large subcontractor.

Lockheed Aircraft Corporation, the largest Department of Defense prime contractor in 1969, has developed a policy offering:

a fair proportion of total purchases for materials, supplies and services to small business concerns. A fair proportion of total purchases is that portion which small business can win in open competition, provided they are given an equitable opportunity to bid.¹

Lockheed feels they make every effort to provide such an equitable opportunity. Or, in their own words:

We try very hard to be sure that visiting suppliers are given a courteous and businesslike reception when they visit our Procurement

¹U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement, Hearings, p. 359.

organizations, and especially for small suppliers making their first visit—make them aware of the fact that there is a Small Business Administrator to give them guidance.

Appropriate publications such as . . . "Welcome to Procurement" and "Small Business Profile" found at Lockheed-California Company . . . all help suppliers to become acquainted with us, of our policies and practices, how Lockheed qualifies suppliers and how to become established.¹

To be sure, Lockheed's program is not entirely motivated by the statutory requirements. They say,

Aside from our responsibilities under the Small Business Subcontracting program, we are motivated to actively seek out the best the market place has to offer, in goods and services, in order to obtain the benefits that may accrue from the availability, quality and competition that may be offered by prospective suppliers.²

However, despite this, the results of Lockheed's program are less than the average reported for all Department of Defense prime contractors. As shown on Table 6, in terms of value Lockheed's percentage of small business awards varies between 27% and 37%. In terms of number of awards, the percent that goes to small business averages about 67%.

The Lear Sigler Corporation, a large subcontractor to major airframe producers³ has an even more viable small business assistance program. Their purchasing policy is to:

place business with the supplier who is qualified to supply the necessary goods and services . . . at the most effective price . . . Purchasing is charged in written policy with the responsibility of not only granting small business the opportunity of bidding on our requirements, but of seeking out and encouraging such companies to participate in our program.⁴

¹ Ibid., p. 1098.

² Ibid.

³ Ibid., p. 1185.

⁴ Ibid., p. 1184.

TABLE 6

LOCKHEED AIRCRAFT CORPORATION SMALL BUSINESS SUBCONTRACTING^a

| CATEGORY | FISCAL YEAR | | | | | |
|--|-------------|-------|---------|---------|-------|---------|
| | 1964 | 1965 | 1966 | 1967 | 1968 | 1969 |
| Total Commitments (\$000,000) | 702.0 | 938.4 | 1,189.5 | 1,073.2 | 894.1 | 1,296.6 |
| Small Business Commitments (\$000,000) | 194.4 | 224.3 | 376.5 | 401.1 | 278.7 | 352.6 |
| Percentage of Small Business Commitments | 27.7 | 23.9 | 31.7 | 37.4 | 31.7 | 27.1 |
| Number of Small Business Awards (000) | N/A | 399.8 | 430.3 | 538.6 | 479.4 | 452.6 |
| Percentage of Small Business Awards | N/A | 68.5 | 66.7 | 67.9 | 66.8 | 64.2 |

^aSource: U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement--Before and After Defense Cuthacks, Hearings before the subcommittee on Government Procurement of the Select Committee on Small Business, House of Representatives, pursuant to H.R. 66, 91st Cong., 2d sess., 1970, p. 1112-1113.

As shown on Table 7, Lear Sigler's award percentage varies between 53% and 63% over the last five and a half years. The average is 57%. The actual number of small business awards is even higher, running up to 80% of the total.

It is clear, then, that the subcontract program, because it offers something to both the large and small business, has been so far a successful and widely used means of providing small business assistance.

TABLE 2

LEAR SIGLER INCORPORATED SMALL BUSINESS SUBCONTRACTING^a

| CATEGORY | FISCAL YEAR | | | | | |
|--|-------------|------|------|------|------|-------------------|
| | 1965 | 1966 | 1967 | 1968 | 1969 | 1970 ^b |
| Contracts Awarded Small Business (\$000,000) | 12.5 | 17.1 | 20.4 | 19.2 | 12.2 | 4.7 |
| Percentage of Small Business Awards | 55 | 54 | 57 | 63 | 57 | 57 |
| Number of Small Business Awards (000) | 24.8 | 35.8 | 37.0 | 31.8 | 27.8 | 12.0 |
| Percentage of Small Business Awards | 78 | 80 | 79 | 80 | 80 | 79 |

^aSource: U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement--Before and After Defense Cutbacks, Hearings before the subcommittee on Government Procurement of the Select Committee on Small Business, House of Representatives, pursuant to H.R. 66, 91st Cong., 2d sess., 1970, p. 1185.

^bFirst six months.

Prime Contract Programs

The set-aside program

In the Small Business Act of 1953 Congress gave the Executive branch of our government the authority for a set-aside program. As the name implies, this program was intended to set aside government contracts exclusively for small business. That is, according to Section 214 of the Small Business Act, the Small Business Administration and the contracting officers were given the authority to set aside proposed procurements for competition solely among small business concerns. However, according to the original act, such action

was only to be taken if the buying agency agreed that it was in the interest of "maintaining or mobilizing the Nation's full productive capacity"¹ or "to be in the interest of war or national defense programs."² Thus, for the first five years after the Small Business Act was passed, contracts were set aside only to forestall a lack of mobilization potential in the event of an emergency. The provisions of an amendment to the Act passed in 1958, however, made the set-aside program a more general part of the policy of supporting small business. That is, contracts could be set aside just for the purpose of obtaining for small business a fair proportion of government contracts. The Act now reads:

Small business concerns . . . shall receive any award or contract or any part thereof . . . as to which it is determined by the Administration and the contracting procurement . . . agency (1) to be in the interest of maintaining or mobilizing the Nation's full productive capacity, (2) to be in the interest of war or national defense programs, (3) to be in the interest of assuring that a fair proportion of the total purchases and contracts for property and services for the government are placed with small business concerns.³

The 1958 act also increased the range of possible set-asides. The original act had permitted only individual procurements to be set aside;⁴ the 1958 amendment changed the act so that it now reads, "These determinations [of the SBA and the buying agency] may be made for individual awards or for classes of awards or contracts."⁵ This streamlining of procedures made it

¹Small Business Act, 15 U.S.C. 631.

²Ibid.

³Ibid.

⁴U.S., Congress, Senate, Select Committee on Small Business, Small Business Programs, Policies, and Procedures of Government Agencies, S. Rept. 2025, p. 2.

⁵Small Business Act, 15 U.S.C. 631.

possible for the government to set aside all procurements for a given item without making a review and determination each time the item was bought.

The set-aside program has evolved today into a principle device to stimulate small business participation in government contracts. Congress feels that:

the set-aside is the most effective method which can be utilized by the procurement activities to comply with the Congressional mandate that a fair proportion of their purchases and contracts be "placed" with small business enterprises.¹

There are a number of ways a set-aside can be classified. As provided in the original Small Business Act, a proposed procurement for a given item or service may be set aside for small business, that is, an item or service for which an activity has an immediate need can be earmarked for small enterprise. This set-aside is termed an individual set-aside. As mentioned above, the 1958 amendment provided for class set-asides. Under a class set-aside, both current and future requirements for an item or group of items are set aside for small business. Class set-asides do not depend upon a current requirement to buy an item if a need may be expected to develop in the foreseeable future. Class set-asides are made at the activity level only. That is, class set-asides are valid only for the purchasing activity that makes them², and there are no Department of Defense or Department of the Navy wide class set-asides.

Set-asides can also be classified according to the amount (a part or all) of the procurement that is set aside, that is, they may be total

¹U.S., Congress, House, Select Committee on Small Business, Position of Small Business in Government Procurement, H. Rept. 1975, p. 12.

²U.S., Department of Defense, Armed Services Procurement Regulation, para. 1-706.1 (c).

set-asides or partial set-asides. Total set-asides are those in which the entire procurement, be it an individual set-aside or a class set-aside, is reserved for small business. Partial set-asides are those set-asides in which only a portion of the procurement is set aside. Partial set-asides can also be made of both class and individual procurements.¹

Finally, set-asides can be classified according to the manner in which they are set aside. Unilateral set-asides are those made by the contracting officer, usually upon the recommendation of the small business specialist; that is, they are the result of a unilateral effort on the part of the buying activity. The other way a procurement can be set aside is by a joint effort of the Small Business Administration and the buying activity. This set-aside is called a joint set-aside.²

Any set-aside, then, is a combination of these three categories. There are a total of eight different combinations. For example, an individual set-aside is also either:

- 1) joint and partial,
- 2) joint and total,
- 3) unilateral and partial, or
- 4) unilateral and total.

The same is true for class set-asides, that is, a set aside could be classified as a class, joint, partial set-aside, a class, joint, total set-aside, etc.

General set-aside procedures

The Department of Defense leaves quite a bit of leeway as far as

¹Ibid., para. 1-706.5 and 1-706.6.

²Ibid., para. 1-706.1

how set-asides can and should be used. In fact, the Armed Services Procurement Regulation contains no general criteria for the use of set-asides. That is, there are no general criteria of a positive nature, but only a list of reasons that cannot be used by a contracting officer to justify not setting aside an individual procurement of a class of procurements. These are that:

- (i) a large percentage of previous procurements of the item has been placed with small business concerns;
- (ii) the item is on an established planning list under the Industrial Readiness Planning Program . . .
- (iii) the item is on a Qualified Products List . . .
- (iv) a period of less than 30 days . . . is prescribed for submission of the bids or proposals;
- (v) the procurement is classified;
- (vi) small business concerns are considered to be receiving a fair proportion of total contracts for supplies and services;
- (vii) a class set-aside of the item or service has been made at some other purchasing activity; or
- (viii) the item will be described by "brand name or equal."¹

The general procedures involved in making a set-aside are not overly complex. First, emphasis is placed throughout on making unilateral set-asides as opposed to joint set-asides. That is, the Department of Defense encourages the contracting officer upon the recommendation of the small business specialist to initiate the set-aside action. Or, in the words of the Armed Services Procurement Regulation, "Insofar as practicable, unilateral determinations rather than joint determinations shall be used as the basis for set-asides."²

The creation of a set-aside, then, usually proceeds as follows: The small business specialist at the buying activity reviews all procurements over \$2,500 for any possibility of setting aside the buy or a portion of the

¹Ibid., para. 1-706.1 (d).

²Ibid., para. 1-706.1 (a).

buy for small business. He then recommends to the contracting officer which proposed buys he feels should or could reasonably be unilaterally set aside for small business. Whichever of these the contracting officer agrees with he proceeds on with an award.

The Small Business Administration representative (if one is available) reviews all proposed procurements over \$2,500 that are not unilaterally set aside.¹ This, of course, includes all those that are recommended by the small business specialist but are rejected by the contracting officer. The contracting officer must explain in writing to the Small Business Administration representative any proposed buy he disapproves for this program. If the representative agrees with his disapproval, the case is settled. Otherwise his disapproval starts what can be a long and time consuming appeal procedure.

First the Small Business representative must prepare a written appeal to the Head of the Procuring Activity; this he must do within two days of his receipt of the disapproval action. Meanwhile the procurement action may be suspended until the case is resolved. In fact, the only way the contracting officer can continue with the buy is if he makes a determination that continuation is necessary in order to protect the public interest. The Head of the Procuring Activity reviews the appeal. If he agrees with the Small Business Administration representative, the buy is set aside; if he agrees with the contracting officer, the Small Business Administration has but one remaining appeal route. It can appeal to the Secretary of the military department concerned. Meanwhile again, the procurement will probably be suspended until this final decision is made.²

¹Ibid.

²Ibid., para. 1-706.3.

When there is no Small Business Administration representative available to appeal the actions of the contracting officer, the small business specialist has one appeal. He can go to the authority that appointed him, usually the Head of the Purchasing Activity. His decision, though, is final, and no further appeals can be made.¹

The general procedures for effecting a set-aside, then, are quite simple; yet, if any proposed set-aside is disapproved somewhere along the line, the procedures become involved and tedious.

Special procedures for total and partial set-asides

In addition to the general criteria and procedures described above applying to all set-asides, the Department of Defense has set up specific criteria and procedures for making total and partial set-asides.

Total set-asides, again, are those whereby the entire individual procurement or class of procurements is set aside for small business. The criteria the contracting officer is to use in determining if a procurement should be totally set aside are stated in the Armed Services Procurement Regulation as follows:

The entire amount of an individual procurement or class of procurements . . . shall be set aside for exclusive small business participation if the contracting officer determines that there is reasonable expectation that bids or proposals will be obtained from a sufficient number of responsible small business concerns so that awards will be made at reasonable prices. Total set-asides shall not be made unless such a reasonable expectation exists. Although past procurement history of the item or similar items is always important, it should not be the only factor which should be considered in determining whether a reasonable expectation exists.²

Proposed procurements that meet this criteria can be awarded to the small businessman in two manners. The first is by negotiation. That is,

¹Ibid.

²Ibid., para. 1-706.5 (a)(1).

one or more small business concerns are selected and the price, delivery schedule, and other terms of the contract are negotiated. The second manner by which a total set-aside can be awarded is by use of a procedure called "Small Business Restricted Advertising."¹ This procedure is similar to formal advertising: Invitations For Bids are prepared and given wide distribution and publicity; prospective contractors then submit their bids; and the lowest responsive and responsible bidder is usually awarded the contract. Small Business Restrictive Advertising differs from formal advertising, however, in that bids are requested only from small businesses. The Invitation to Bid contains a notice stating that bids are requested only from small business firms and that the contract will only be awarded to a small firm. It states further that any bids received from firms that do not qualify as a "small business" will be considered nonresponsive and will be rejected.² Thus, large business is excluded from obtaining any contracts that have been totally set aside for small business. The only exception to this is if, for some reason, a set-aside cannot be totally awarded to small business, in which case the contracting officer is free to turn to any firm (large or small) for the procurement.

Partial set-asides, that is, those in which only a portion of the procurement (either individual or class) is set aside for small business, differ entirely from total set-asides in terms of when they are used and how they are made.

According to the Armed Services Procurement Regulation, the contracting officer should consider a partial set-aside for any procurement

¹Ibid., para. 1-706.5 (b).

²Ibid., para. 1-706.5 (c).

that meets the following criteria:

- (i) the procurement is not appropriate for total set-aside . . .
- (ii) the procurement is severable into two or more economic production runs or reasonable lots . . .; and
- (iii) one or more small business concerns are expected to have the technical competency and productive capacity to furnish a severable portion at a reasonable price except that a partial set-aside shall not be made if there is a reasonable expectation that only two firms (one large and one small) . . . will respond with bids or proposals.¹

The first step in making a partial set-aside is to divide the procurement into a set-aside and a non-set-aside portion. This division is made by the contracting officer, usually on the basis of what would be economic production runs. Then the total procurement, that is, both the set-aside and the non-set-aside portion is advertised. Both large and small firms may bid, since all bid only on the non-set-aside portion. That portion is then awarded to the lowest responsive and responsible bidder. After this award has been made, negotiations commence on the set-aside portion of the procurement. Negotiations proceed with all small businesses who bid within 130% of the price awarded the non-set-aside portion, proceeding first with the lowest bidder, then the second lowest, etc., until the set-aside is awarded. The small businessman who receives the award, however, must agree to the same award price which was given the non-set-aside portion of the procurement; the award price of the set-aside can never be higher than the non-set-aside award price. In the case that multiple awards were made on the non-set-aside portion, the price of the set-aside cannot be higher than the highest unit price of the non-set-aside award. If, by any chance, because of these technicalities the set-aside portion cannot be totally awarded to small business, the contracting officer is entirely free to procure that portion of the procurement from any (large or small) firm

¹Ibid., para. 1-706.6 (a).

using any procurement method.

As complex as it may appear, the procedure just described was the making of a partial set-aside at its simplest. The program is further complicated by the fact that it is "married", so to speak, to the Labor Surplus Program. This socio-economic program is similar to the Small Business Program in that it tries to channel government contracts to a specific group of manufacturers, in this case, to firms (large and small) in areas of the country that are suffering from unemployment. There are three degrees of unemployment, the first taking precedence over the second and third, and the second taking precedence over the third. The three degrees are:

1. concentrated unemployment or underemployment;
2. persistent and substantial labor surplus;
3. substantial labor surplus.¹

Actually, then, when negotiations are initiated with small businesses for the set-aside portion of a partial set-aside, they proceed in order of the classification of the businesses in terms of Labor Surplus. That is, negotiations are initiated first with the lowest bidding small business in an area of "concentrated unemployment", next with the second lowest bidder in such an area, etc. If the set-aside portion is not totally awarded to firms in "concentrated unemployment" areas or if there are none bidding from such an area, negotiations can then begin with the lowest bidding small business firm in an area of "persistent labor surplus". And so it goes, next to small firms in areas of "substantial labor surplus" and finally to small businesses that are not located in a labor surplus area.²

¹Commerce Clearing House, 1969 Government Contracts Guide (Chicago: Commerce Clearing House, Inc., 1969), p. 82.

²U.S., Department of Defense, Armed Services Procurement Regulation, para. 1-706.6 (c).

Performance of the set-aside program

What has been the performance of this sometimes complicated and often resource consuming procedure? Figure 1 graphically depicts the value of the set-asides awarded small business during the last ten years.



Figure 2

SET-ASIDE AWARDS TO SMALL BUSINESS^a

^aSource: U.S., Congress, House, Select Committee on Small Business, Small Business Subcontracting and Set-Aside Programs, Hearings before the subcommittee on Government Procurement and Economic Concentration of the Select Committee on Small Business, House of Representatives, pursuant to H.R. 53, 90th Cong., 1st and 2d sess., 1968, p. 346 and U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement--Before and After Defense Cutbacks, Hearings before the subcommittee on Government Procurement of the Select Committee on Small Business, House of Representatives, pursuant to H.R. 66, 91st Cong. 2d sess., 1970, p. 346.

The amount of the awards (\$1.5 billion in 1970) is quite large and the ten year trend is generally up. During the same period the total expenditures made by the Department of Defense has also increased, and as shown on Figure 2, the relative percentage of small business set-aside awards has also increased.

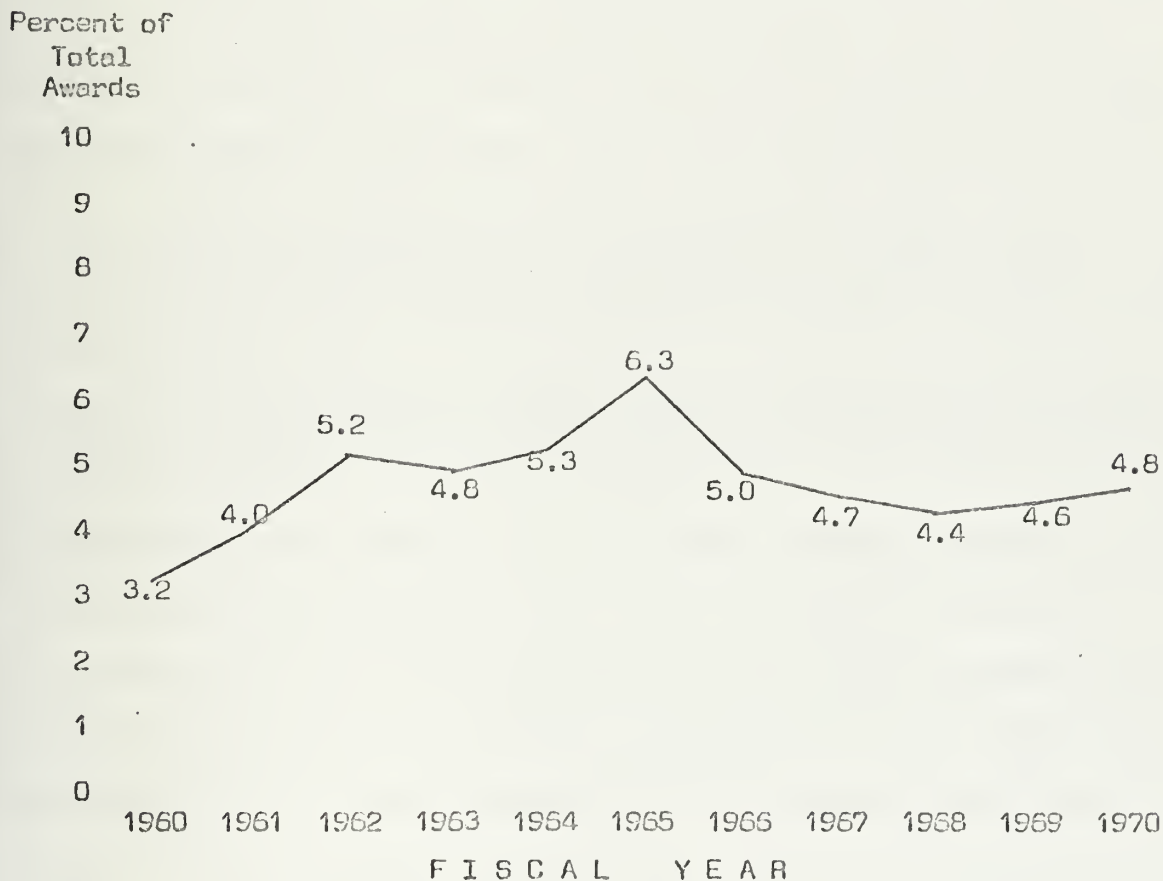


Figure 2

SMALL BUSINESS SET-ASIDE PERCENTAGE OF TOTAL AWARDS^a

^aSource: U.S., Congress, House, Select Committee on Small Business, Small Business Subcontracting and Set-Aside Programs, Hearings before the subcommittee on Government Procurement and Economic Concentration of the Select Committee on Small Business, House of Representatives, pursuant to H.R. 53, 90th Cong., 1st and 2d sess., 1968, p. 346 and U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement--Before and After Defense Cutbacks. Hearings before the subcommittee on Government Procurement of the Select Committee on Small Business, House of Representatives, pursuant to H.R. 66, 91st Cong., 2d sess., 1970, p. 346.

A comparison of Figure 2 and Figure 3 shows that the rise in the percentage of set-asides has not been as dramatic as the rise in the value of total small business set-asides. Of particular note is the 1966-1968 period of large Vietnam expenditures. The set-aside percentage dropped dramatically at this time, probably in the rush to get needed material on order. Also, at the same time the Small Business Administration representatives were withdrawn from many procurement centers in an economy move, and this undoubtedly had its toll. Gone was a strong small business voice on the scene when contracts were awarded. Or, in the words of Congress:

In short, the PCR [procurement center representative] was the advocate of small business in the Government procurement agency . . . it is only when SBA aggressively pushes the set-aside program . . . that small business has a chance to participate equitably in government procurement . . .

The subcommittee is convinced that the decline in the small business share of DOD procurements following fiscal year 1965 is due to the failure of procurement agencies on their own to look after the interests of small business as intended by Congress.¹

The conclusions of Congress are probably valid. Without the Small Business Administration representative, extra effort was required to set aside procurements for small business; since at the same time there was a military requirement to buy items in a hurry, set-asides were just not made. The turnaround since then from a downward trend to a slight upturn today is probably indicative of the Small Business Administration representative's return to the scene.

Assistance for small business in competition with large business

The final prime contract assistance technique simply involves government support for the small businessman when he is willing to compete

¹U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement, H. Rept. 91-1008, pp. 8-9.

on his own against large business for prime government contracts. In contrast to the other programs, there are no complicated criteria for when this assistance will be provided; it is simply whenever the small businessman wants to compete on the open market for the defense dollar. Likewise, this assistance technique has no formal procedures.

The principle assistance rendered the small businessman when he competes against large firms for contracts is in the way of publicity. Every effort is made to assure that proposed procurements are given wide enough publicity that the small businesses who might be capable of competing for them will know about them. Major proposed procurements are listed in the Department of Commerce publication "Commerce Daily". Procurements are also formally advertised to small businesses, that is, small businesses receive written Invitations For Bids on specific procurements. As Table 8 shows, in Fiscal Year 1970 over 70% of proposed Department of Defense procurements received publicity which was known to have been publicised to the small businessman.

The other assistance measure offered to the small businessman when he competes with large business is the preference given him in tie bids. That is, in the event that two or more bids are equal in all respects, small business will get preference for the award. However, here again small business must accept its place in regard to labor surplus. The labor surplus area program always has preference over the small business program. Therefore, priority in the event of a tie bid is given: first, to small business firms in areas of concentrated unemployment; second, to other firms in areas of concentrated unemployment; third, to other labor surplus categories; and finally, to small businesses that are not in labor surplus areas.¹

¹U.S., Department of Defense, Armed Services Procurement Regulation, para. 2-407.6.

TABLE 8

AWARDS PUBLICIZED TO SMALL BUSINESS (EXCLUDING CIVIL FUNCTIONS)^a
(\$000,000)

| CATEGORY | FISCAL YEAR | | | | |
|---|-------------|--------|--------|--------|--------|
| | 1965 | 1967 | 1968 | 1969 | 1970 |
| Publicized to Small Business (Amount) ^b | 23,979 | 27,992 | 25,821 | 24,889 | 22,894 |
| Publicized to Small Business (Percentage) ^b | 70.5 | 70.3 | 65.4 | 66.7 | 73.4 |
| Not Publicized to Small Business (Amount) | 8,503 | 10,046 | 12,077 | 10,822 | 6,835 |
| Not Publicized to Small Business (Percentage) | 25.0 | 25.2 | 30.6 | 29.2 | 21.9 |
| Not Known if Publicized to Small Business ^c (Amount) | 1,548 | 1,770 | 1,587 | 1,558 | 1,461 |
| Not Known if Publicized to Small Business ^c (Percentage) | 4.5 | 4.5 | 4.0 | 4.1 | 4.7 |

^aSource: Office of the Secretary of Defense, Military Prime Contract Award and Subcontract Payments or Commitments July 1967-June 1968, July 1968-June 1969, July 1969-June 1970, p. 16.

^bIncludes those procurements synopsisized and listed in the "Commerce Business Daily" and those that were not listed in the "Commerce Business Daily" but were formally advertised or proposals were requested from small business.

^cNegotiated awards of less than \$10,000 that were awarded to large concerns.

In competition with large business, small business does quite well.

Table 9 reflects the dollar value and the percentage of the total Department of Defense awards that small business received when competing with large.

TABLE 9

AWARDS TO SMALL BUSINESS WHEN COMPETING WITH LARGE BUSINESS^a
 (\$000,000)

| CATEGORY | F I S C A L Y E A R | | | | |
|--|------------------------|--------|--------|--------|--------|
| | 1966 | 1967 | 1968 | 1969 | 1970 |
| Total Awards to All Firms | 34,878 | 40,609 | 40,304 | 37,986 | 31,777 |
| Small Business Set-Aside Awards | 1,729 | 1,906 | 1,773 | 1,747 | 1,525 |
| Small Business Awards Not Set Aside | 5,882 | 6,453 | 5,811 | 5,018 | 3,966 |
| Percent of Awards Not Set Aside to Total | 16.8 | 15.9 | 14.4 | 13.2 | 12.5 |

^aSource: U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement--Before and After Defense Cutbacks, H. Rept. 91-1603, 91st Cong., 2d. sess., 1970, p. 5 and p. 14.

However, as shown on Table 9, the amount and percentage of the Defense dollar the small businessman is receiving in this manner is declining rapidly. As total defense expenditures drop, the large businessman is bidding on and receiving a larger proportion of the contracts when he competes with small business.

Summary

Over the years Congress and the Department of Defense have made public their recognition of the economic importance of the small businessman by developing a policy of assisting him. In short, this policy is to place a fair proportion of purchases made for supplies and services with small

business.

The Department of Defense, which assumes a major role in implementing this policy, has a relatively simple organizational approach for doing so. There are staff advisors at the headquarters level to advise the Department Secretaries on small business matters and to act as spokesmen for small business when new policy is made. The major responsibility for implementing the assistance programs, however, is placed in the hands of men in the field who are close to where the contracts are made. These are the small business specialists.

There are four major Department of Defense assistance programs. Two help the small businessman to receive subcontracts; two help him to get prime contracts.

The Section 8(a) subcontract program is used primarily to develop and assist the emergent minority enterprise and, as such, has received little use or even publicity until recently. Nor do the prospects for much more emphasis on this program in the future look likely.

The other subcontract assistance technique, referred to simply as the subcontract program, is used substantially. In every Department of Defense major prime contract is a clause which requires the contractor to set up a subcontract program. Accordingly the contractor must, among other things, agree to give small business an equal bid opportunity, consider him in make or buy decisions, and make an effort to locate additional small business sources. As a result of this program, small business received over 36% of the value of subcontracts awarded by the total 934 prime contractors who reported on their programs in 1970.

Of the two prime contract assistance techniques, it is the set-aside program which consumes the most resources within the Department of Defense.

Under this program procurements either for the current requirement of a given item (individual) or for the current and future requirement of an item or group of items (class) are set aside either by the contracting officer on the recommendation of the small business specialist (unilateral) or because of the combined effort of the Small Business Administration and the purchasing activity (joint). These procurements can either be totally set aside for small business or can be divided up and given partially to the lowest bidder (large or small) and partially to small business. Although there are a number of technicalities involved in awarding set-asides, particularly when labor surplus must also be considered in the award of a partial set-aside, the real resource consuming aspect of this program comes when the contracting officer and the Small Business Administration disagree on whether a procurement should be set aside. The complexity of this program may account for the fact that although the dollar amount the small businessman receives from set-aside contracts is substantial (\$1.5 billion in 1970), the relative percentage as far as total Department of Defense contracts is low (4% to 6%).

Another type of prime contract assistance the small businessman receives is provided when he competes with large business for contracts. In actuality this assistance amounts to little more than seeing that information on proposed procurements is published where the small businessman can find it and seeing that, in the event of a tie bid, the small business is given preference (secondary to labor surplus, of course). Nevertheless, the small businessman receives a larger percentage of the Department of Defense dollar by competing with large business on his own (\$4 billion in 1970) than by receiving set-asides (\$1.5 billion). It is noteworthy that the program that involves the most resources is not the one that produces the best results.

By combining the percentage received from prime and subcontracts, an estimate of the total amount small business receives can be made. Table 10

is such an estimate. Just going to the first tier subcontractor, the total small business percentage is up to 43.5%. If the analysis were extended to the third or fourth tier subcontractor, an additional one or two percentage points would surely be gained.

TABLE 10

ESTIMATED TOTAL SMALL BUSINESS AWARDS (PRIME AND SUBCONTRACTS)^f

| CATEGORY | TOTAL | | SMALL BUSINESS | |
|--|---------------------|---------|---------------------|---------|
| | Amount ^a | Percent | Amount ^a | Percent |
| TOTAL FISCAL YEAR 1970 | \$31,777 | 100% | | |
| less: | | | | |
| Small Business Awards | 5,491 | 17.3 | \$5,491 | 17.3% |
| LARGE BUSINESS AWARDS | \$26,286 | 82.7% | | |
| less: | | | | |
| Prime expenditure for in house work ^b | 14,45 | 42.2 | | |
| less: | | | | |
| Small Business Subcontracts ^c | 4,360 | 14.9 | 4,360 | 14.9 |
| LARGE BUSINESS SUBCONTRACTS | \$ 7,521 | 25.6% | | |
| less: | | | | |
| Subcontract expenditures for in house work ^d | 1,729 | 5.8 | | |
| Small Business Subcontracts ^e | 3,300 | 11.3 | 3,300 | 11.3 |
| Large Business Subcontracts | 2,492 | 8.5 | | |
| TOTAL SMALL BUSINESS AWARDS | | | \$13,151 | 43.5% |

^a Amounts in millions.

^b Average (51% for Lockheed Aircraft Corporation 1965-1969.

^c Fiscal Year 1970 percentage (36.7% reported on Table 5).

^d Average (23%) for Lear Sigler Incorporated 1965-1969.

^e Average (57%) for Lear Sigler Incorporated 1965-1969.

^f Source: U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement, Hearings, p. 1116 and p. 1185.

Overall, then, it can be safely said that the small businessman receives a fairly large proportion of the Defense contract dollar. Whether this is because of or whether it happens despite the procedures involved in the four Department of Defense assistance programs must be evaluated. The evaluation of these procedures is therefore the subject of the following chapter.

CHAPTER IV

EFFECTIVENESS OF THE ASSISTANCE PROGRAMS

With the reasons for assisting small business firmly established, the evolution of government assistance explored, and the present day policies and procedures explained, a meaningful evaluation of the Department of Defense's small business assistance programs can be made. That is, just how effective are the programs in meeting the Congressional policy of assistance?

To evaluate the programs in their true light would be to see them through the eyes of the three groups who are actively involved with them, that is, to assume the position of the Small Business Administration, the Department of Defense, and the small businessman. To be sure, each of these would view the programs differently, since any evaluation is necessarily influenced by the evaluator's background, prejudices, and organizational loyalty. First, the viewpoint of the Small Business Administration can be assumed. Their whole reason for being is to assist the small businessman. Naturally, they would feel favorably toward any programs designed with the small businessman in mind; their viewpoint would tend to accentuate the positive results the programs have accomplished. Although there may be procedures of implementation they would like to improve, they would in general be the assistance programs' proponents. The Department of Defense, on the other hand, is not so much interested in giving aid to a particular segment of the country's industry as they are concerned about getting the materials they need when they need them as economically as possible. They

would not tend to view favorably any programs, however noble in purpose, which might tend to delay, complicate, or increase the costs of buying needed items and services. The small business assistance programs at times are guilty on all three of these counts. Therefore the point of view of the Department of Defense is more likely to emphasize the manner in which the programs are ineffective, antagonistic to other government goals, and frequently more frustrating than they are worth. Finally there is the small businessman. One would expect that he, the object of the programs, would be full of praise for them, but he is more likely to be somewhat ambivalent towards them. The programs do bring him additional business. But they also bring him the additional problems of red tape and the excessive amount of paperwork required to obtain and execute a contract. He, then, would be neither the programs' proponent nor opponent; his viewpoint would be neutral.

Viewpoint of the Small Business Administration

The viewpoint of the Small Business Administration, the chief proponent of the assistance programs, emphasizes the many benefits, both for the small businessman and the nation as a whole, that have resulted from the assistance programs. Contracts awarded because of these programs have sent billions of dollars in the direction of the small businessman; further, by increasing the number of suppliers, the programs have helped strengthen competition in this country, helped save the government money, provided opportunity to the innovative small businessman, and increased the nation's mobilization base. From the Small Business Administration's viewpoint, the implementation of the programs could be improved; there appear to be too many procedures which tend more to complicate than expedite the programs. From their stand point, the Department of Defense doesn't always seem so wholehearted in its efforts to execute its stated policy of assistance.

Benefits

From the viewpoint of the Small Business Administration, the primary benefit of the assistance programs would be the amount of dollars that have been channeled to small business by way of prime defense contracts. Figure 3 graphically portrays this.

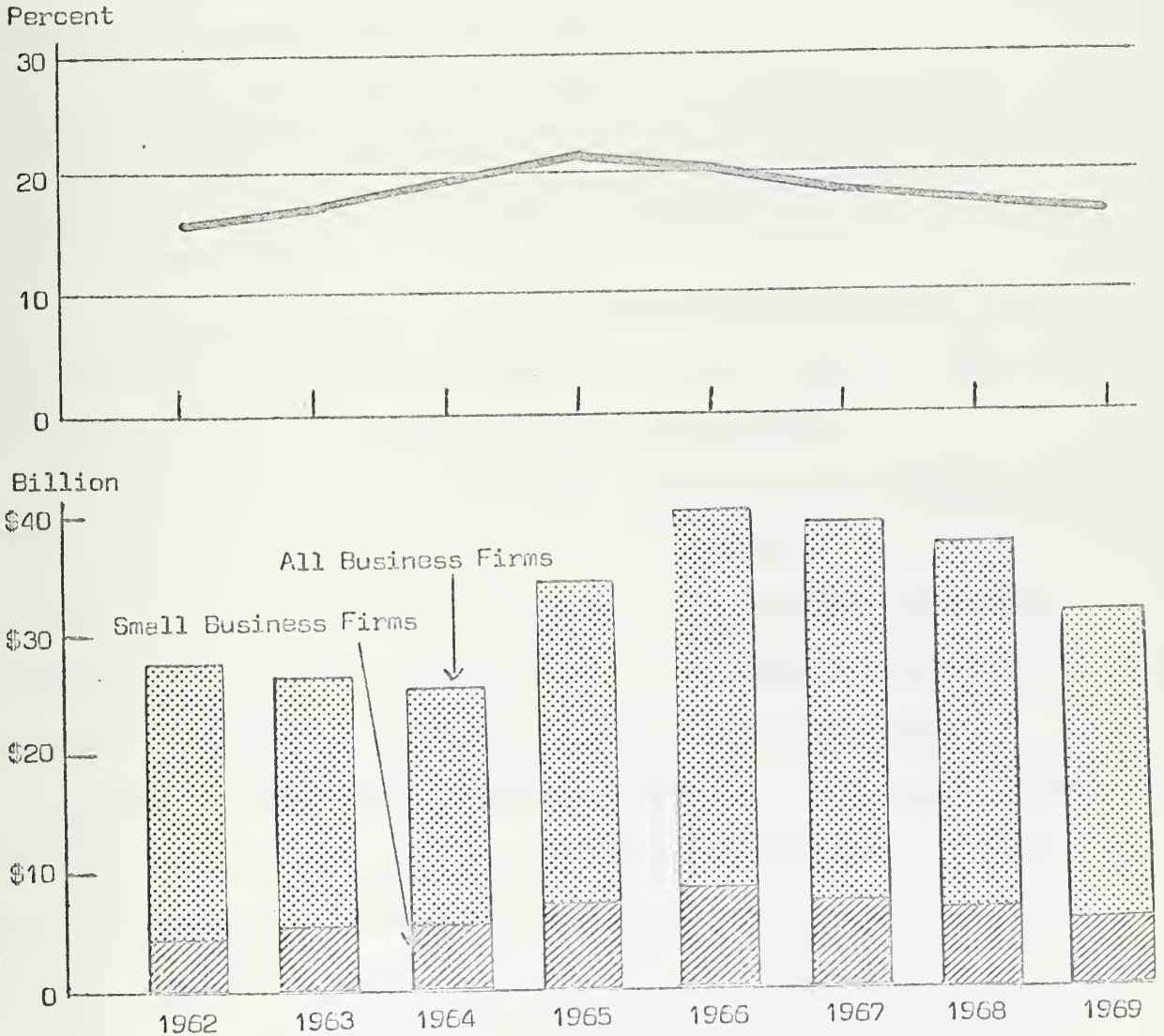


Figure 3

AWARDS TO SMALL BUSINESS^a

^aSource: Department of Defense, Military Prime Contract Awards and Subcontract Payments or Commitments: July 1969 - June 1970, (Washington, D.C.: Government Printing Office, 1970), p. 15.

Although there appears to be a recent decline in the percentage of awards going to small business (possibly the result of large Vietnam expenditures for aircraft, weapons, and ammunitions, all which traditionally have low small business potential) the overall record is noteworthy. Small business has received \$34 billion in the last five years. What has been the role of the assistance programs in channeling these Department of Defense dollars to small business? In the words of one writer:

The question then arises: Would these small enterprises have received just as much business in the absence of the government's assistance programs? The answer, in this writer's opinion, is an unqualified "no". While it is not possible to say how much more business small firms have received because of the programs, the amount must be substantial.¹

The assistance programs have also benefited the nation as a whole. They have helped to increase the number of suppliers, which, in itself, has far reaching effects on the nation's economy and security.

Although all of the techniques have a hand in increasing the number of suppliers, one significant means from the viewpoint of the Small Business Administration is by the use of Certificates of Competency. Whenever a contracting officer receives a low bid from a small business source whose capability he questions, he refers the matter to the Small Business Administration. They in turn evaluate the firm's financial capability and the extent of the firm's capacity for performing the contract. If both meet their criteria, a Certificate of Competency is issued and another government supplier is born.

By so increasing the number of suppliers, the assistance programs have helped substantially to strengthen competition in this country. As the 1953 White House Small Business Committee stated:

¹Kennard Weddell, Aiding Small Industry Through Government Purchases (Menlo Park, California: Stanford Research Institute, 1960), p. 16.

Small business enterprises provide the most fertile soil in which healthy competition may flourish. Small and independent businesses supply the strength and vigor so necessary to the growth of our competitive forces . . . Any development which makes it more difficult for efficient small firms to survive strikes a blow at competition.¹

By so increasing competition, an increase in the number of suppliers also serves to lower costs. Or, from the viewpoint of the Small Business Administration, increasing the number of small business suppliers means saving the government dollars. In the words of Kennard Weddell of the Stanford Research Institute:

It has been found that when an item to be purchased and the conditions of procurement are such that small business concerns can be included in the competition, these concerns offer the lowest prices in 70 percent of the procurements, measured in dollar value.²

For the Defense Department's procurements this percentage is not as high, but it was for 1969 almost 50 percent, still a substantial amount.³ That the programs save the government money has been proved empirically by the Small Business Administration. The House Committee on Small Business reported that:

SBA conducted a study of 57 Government purchases which were made from small firms because the procurements were set-aside or through SBA's efforts small firms were brought into competition. According to the report in these 57 cases, the Government saved more than \$7 million on the purchases. This was the difference between the small firm's bid and the prices which the purchasing agency had previously paid or would have paid to the next lowest bidder.⁴

The Air Force reported that in one procurement in which it made a specific effort to encourage small business competition, it saved enough money to pay

¹White House Committee on Small Business, Why Help Small Business?, p. 4.

²Weddell, Aiding Small Industry, p. 16.

³U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement, Hearings, p. 369.

⁴U.S., Congress, House, Select Committee on Small Business, Small Business Subcontracting and Set-Aside Programs, H. Rept. 2341, 89th Cong., 2d. sess., 1966, p. 43.

for the cost of the Air Force small business program for more than three years.¹ The Certificate of Competency program, by seeing that more suppliers are brought into the field of government procurement, makes a particular contribution to this kind of savings; in fact, since only the low bidding firms are referred to the Small Business Administration a savings results almost every time a Certificate is issued. As shown on Table 11 the savings that result from the Certificate of Competency program are sizable.

TABLE 11
CERTIFICATE OF COMPETENCY PROGRAM^a

| CATEGORY | 1968 | 1969 | 1953-1969 |
|---|------------|------------|-------------|
| Number Issued | 148 | 104 | 2,363 |
| Value (dollars) | 41,744,000 | 10,298,239 | 458,921,000 |
| Awards with C.O.C. | 124 | 108 | 2,189 |
| Value (dollars) | 24,078,000 | 13,062,000 | 408,288,000 |
| Savings (dollars) | 2,367,000 | 1,355,000 | 33,557,000 |
| Awards without C.O.C. | 113 | 144 | 668 |
| Value (dollars) | 21,052,000 | 28,757,000 | 126,134,000 |
| Savings | 1,805,000 | 2,656,000 | 10,937,000 |
| Combined Awards (with and without C.O.C.) | 237 | 252 | 2,857 |
| Combined Value | 45,130,000 | 41,819,000 | 534,422,000 |
| Combined Savings | 4,172,000 | 4,011,000 | 44,500,000 |

^aSource: U.S. Congress, House, Select Committee on Small Business, Small Business in Government Procurement--Before and After Defense Cutbacks, Hearings before the subcommittee on Government Procurement of the Select Committee on Small Business, 91st Cong., 2d sess., 1970, p. 818.

¹Weddell, Aiding Small Industry, p. 16.

Since 1953 when the programs were started the savings amounted to over 35.5 million dollars. Even more savings result when the contracting officer goes ahead with the award after the Small Business Administration has completed only a portion of its Competency review but assures that a Certificate will be issued. Contracting officers now seem to be doing this more frequently (250 out of a total 668 contracts awarded in this manner were made in the last two years), and as shown on Table 11, it has meant 10.9 million dollars more savings.

By increasing the number of suppliers the assistance programs also benefit the nation's security. More government suppliers means a broader mobilization base. From a military point of view this is quite valuable. First, in the event of an emergency, many widely dispersed plants will be able to respond much quicker than one or two large centralized plants. Additional benefit is gained by having a decentralized mobilization base. In the event of an attack, a widely dispersed industrial base is less vulnerable. This could, but hopefully will not, be of great importance at sometime in the future.

An increased number of suppliers can mean an increase in the number of sources of new ideas and procedures for the government. As Elmer F. Ward, President of Strategic Industries Association, an organization of small businessmen, recently stated:

Small business is the engine of industry. Origination, innovation, creation, is a uniquely individual accomplishment. It is an experience you cannot explain. You must be there to understand it. The small businessman--and I am referring here to the proprietary product or skill company--knows what I am talking about. He has been there. He has come up with some design, process or skill that beats competition. Without that uniqueness, he cannot survive.

More than half of all patents result from individuals or small

business. You may not be able to find the research and development budget, but you cannot deny the innovative function. It is there and still working.¹

Likewise, Douglas Dillman, an executive of the Small Business Association of New England, recently stated that:

Small Business has many competitive advantages over large companies, such as: 1) ingenuity, 2) inventiveness, 3) proprietary know-how, 4) less inertia, 5) much lower overhead . . . 6) special unique facilities and capabilities.²

By assisting the small businessmen, then, the government is assisting a segment of industry which has the potential of offering quite a bit in return. From the viewpoint of the Small Business Administration, there is good reason to be a mighty advocate of the assistance programs.

Limitations

The viewpoint of the Small Business Administration, while committed to the positive and valuable effects of the assistance programs, is cognizant of ways they could be made more valuable: it sees that billions of dollars worth of defense contracts are never even offered to the small businessman; contracting officers' efforts on behalf of small business are not always wholehearted; and there are a number of practices and procedures within the buying agencies that seem more detrimental than helpful.

It is true that there are a lot of Department of Defense procurements that are not offered to the small businessman. Table 12 shows that the value of contracts not offered to small business has risen over the last five years from a low of \$15 billion in 1965 to a high of \$24 billion in 1968.

¹U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement, Hearings, p. 170.

²U.S., Congress, House, Select Committee on Small Business, Small Business Subcontracting and Set-Aside Programs, Hearings, pp. 592-593.

TABLE 12

PROCUREMENTS NOT OFFERED TO SMALL BUSINESS^a

| CATEGORY | FISCAL YEAR | | | | |
|----------------------------|-------------|--------|--------|--------|--------|
| | 1965 | 1966 | 1967 | 1968 | 1969 |
| Total Awards | | | | | |
| Amount (\$000,000) | 26,113 | 34,878 | 40,690 | 40,340 | 37,986 |
| Percent | 100 | 100 | 100 | 100 | 100 |
| Not Offered Small Business | | | | | |
| Amount (\$000,000) | 15,101 | 19,135 | 23,273 | 24,699 | 23,492 |
| Percent | 58 | 55 | 57 | 61 | 62 |
| Offered to Small Business | | | | | |
| Amount (\$000,000) | 11,012 | 15,743 | 17,366 | 15,605 | 14,494 |
| Percent | 42 | 45 | 43 | 39 | 38 |
| Small Business Awards | | | | | |
| Amount (\$000,000) | 5,305 | 7,611 | 8,361 | 7,584 | 6,765 |
| Percent | 20 | 22 | 21 | 19 | 18 |

^aSource: U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement--Before and After Defense Cutbacks. Hearings before the subcommittee on Government Procurement of the Select Committee on Small Business, House of Representatives, pursuant to H.R. 66, 91st Cong., 2d sess., 1970, p. 346 and p. 369.

Figure 4 portrays the drop in the percentage that was offered to small business. Comparing the amount and the percentage of the buys that were offered to small business to the amounts awarded small business, there is a definite correlation between the two. For, if a proposal or bid is not requested from small business, he has little chance of receiving the award. The small firm can on its own request a copy of the solicitation and make a reply; however, he doesn't do this frequently. Overall, the Small Business Administration feels the trends are not encouraging. Small business is excluded from a larger portion of the defense market each year, and the proportion of the awards he receives is also decreasing.

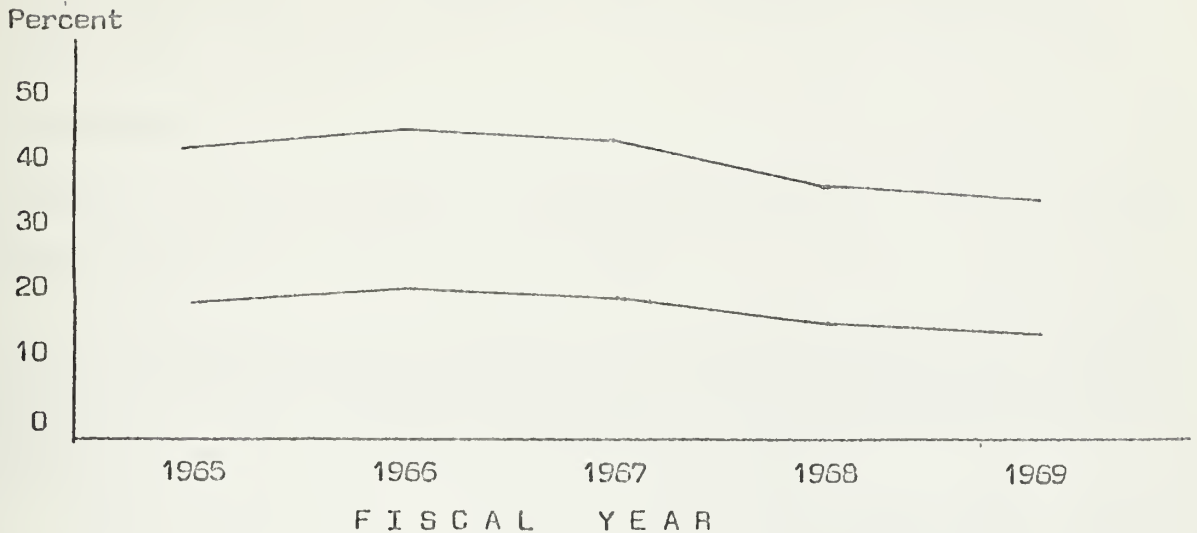


Figure 4

PERCENTAGE OFFERED AND WON BY SMALL BUSINESS^a

^aSource: U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement--Before and After Defense Cutbacks, Hearings before the subcommittee on Government Procurement of the Select Committee on Small Business, House of Representatives, pursuant to H.R. 66, 91st Cong., 2d sess., 1970, p. 346 and p. 359.

The Small Business Administration is also critical of the attitude of the contracting officer; it does not always seem to be one of assisting the small businessman. A Congressional Small Business Committee has stated:

The subcommittee's records covering many years of studies and investigations, as well as the records of the subcommittee's hearings, during this Congress support the conclusion that contracting officers, as a rule, are not special advocates of small business.¹

Regarding set-asides, the Committee reiterated its feelings. It stated:

The subcommittee's investigation and hearings through the years leaves little doubt that the attitude of too many contracting officers in the field is not conducive to the establishment of small business set-asides. In many instances appropriate set-asides are not made. In other instances, procurements traditionally set aside for exclusive

¹U.S., Congress, House, Select Committee on Small Business, Small Business Subcontracting and Set-Aside Programs, H. Rept. 2341, p. 94.

small business bidding are unjustly and unexplainably discontinued. Such determinations, detrimental to small business, are made without appeal and, in many cases, with the approval of the procuring agency's small business specialists.¹

A former director of the Small Business Administration before a Senate Small Business Committee lamented the problem of getting the field activities to follow headquarter's policy when he stated:

I would be less than candid if I did not mention the ofttimes, in my opinion, these policies [a fair share for small business] are not really administered at the further reaches of the procurement agencies of the government. I am talking more specifically of the contracting officers, those immediately responsible for direct purchasing.²

Nor are the practices of the buying activities without fault. There are three practices in particular that have received Congressional attention.³

They are that buying activities tend to:

1. Consolidate requirements.
2. Issue restrictive specifications.
3. Negate Certificates of Competency.

Consolidating a requirement may have merits to the buying activity because of the price reduction which can usually be obtained by making volume buys. However, when the requirement is consolidated, it may then be beyond the capability of small business to produce.

Unduly restrictive specifications have been a long standing problem for small and large business alike. While the government and industry continually look for ways to reduce "gold plating" and too close tolerance⁴,

¹U.S., Congress, House, Select Committee on Small Business, Position of Small Business in Government Procurement, H. Rept. 1975, p. 13.

²U.S., Congress, Senate, Select Committee on Small Business, Role of Small Business in Government Procurement, Hearings before the Select Committee on Small Business, Senate, 88th Cong., 2d sess., 1964, p. 194.

³U.S., Congress, House, Select Committee on Small Business, Small Business Subcontracting and Set-Aside Programs, H. Rept. 2341, p. 94.

⁴For example, by way of the Value Analysis or Value Engineering programs of the Department of Defense and industry.

this practice continues to hurt the small businessman especially. He may not have the technical skill of large business required to meet the close tolerances of many specifications.

The practice of negating the Certificate of Competency efforts of the Small Business Administration is the detrimental buying activity practice that receives the most Congressional attention. The procedures require that if a small business is low bidder on a proposed procurement and the contracting officer questions his capacity or credit, the matter is referred to the Small Business Administration. If the Small Business Administration issues a Certificate of Competency, i.e., if it vouches for the capacity and credit of the small firm, the contracting officer cannot disqualify the firm for these reasons. He can, however, successfully disqualify the firm on the basis of "tenacity and perserverance".¹ That is, he can never question the "capacity and credit" of a firm, question only "tenacity and perserverance" and thereby never have to refer the matter to the Small Business Administration. Or, the contracting officer can simply disqualify the firm on the basis of tenacity and perserverance after a Certificate of Competency has been issued. Congress reported that:

SBA testimony on this subject disclosed instances in which the SBA notified the contracting officer that his determination to withhold the award based upon the alledged lack of capacity and credit was to be reversed, whereupon the contracting officer promptly refused the award on the ground of alledged lack of tenacity and perserverance.²

In the three years period from fiscal year 1957 through 1969, there were a total of 665 small business "tenacity and perserverance" disqualifications.³

¹U.S., Department of Defense, Armed Services Procurement Regulation, paras. 1-900 and 1-903.

²U.S. Congress, House, Select Committee on Small Business, Position of Small Business in Government Procurement, H. Rept. 1975, p. 23.

³U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement, Hearings, p. 371.

From the viewpoint of the Small Business Administration, then, the assistance programs could be improved if some of the practices and attitudes of the Department of Defense were changed, especially those that are in conflict with the stated desires and policies of top Department of Defense officials.

Viewpoint of the Department of Defense

To assume the position of the Department of Defense would lead us to an entirely different evaluation of the small business assistance programs. The Department of Defense in its procurement has one overriding objective, and that is, in whatever it buys, to get the best combination of price and quality. Because of the tremendous amount of buying that is done, this objective must take precedence over other stated objectives, such as that of assisting small business. Therefore the viewpoint of the Department of Defense towards the small business assistance programs is more likely to be critical than favorable. From their point of view, it would seem that the programs were contrary to normal practice, involve excessive administrative effort and expense, ultimately result in higher prices, bring too many suppliers into the market who cannot deliver the items or service for which they have a contract, and generally cause more problems (particularly of definitions) than are generally acknowledged.

It would be valid to accuse the assistance programs of being contrary to normal purchasing practices. It is not a normal purchasing practice to restrict competition or give preference to a particular set of suppliers. Normally a buyer makes every effort to get the maximum competition that is available. The set-aside program particularly is guilty of restricting competition, i.e., it permits only one segment of the

nation's industry (small business) to compete for an award. In the view of Lamar Lee and Donald Dobler, "Their [socio-political programs] greatest impact is to frustrate government buyers as an additional restriction on their authority to select suppliers."¹

Because the programs don't follow normal purchasing procedures, they do increase the administrative effort and therefore the lead time required to award a contract. Buying, especially government buying, is a very complex procedure, but as one writer stated, "the process is made even more tedious by the added requirements which have nothing to do with the article being bought."² Again, it is the set-aside program which is one of the worst offenders. First of all the program demands that a small business specialist review all procurements over \$2,500 and make his recommendations to the contracting officer. After this procedure, if the buy is not unilaterally set aside, the Small Business Administration representative must review it; if he thinks it should have been set aside, he can initiate appeal procedures. Then the problem of defining "small business" can enter the picture. Time is consumed in determining whether a bidder is really "small business", particularly if the businessman appeals the determination that he is not to a Regional Small Business Administration Director or to the Size Appeal Board in Washington, D.C. Suppose by now that the contracting officer has agreed to set the buy aside but feels that the low bidder does not have the capability to perform the contract. A Certificate of Competency review is then started, and the award is further delayed. Since just appealing a size determination and instituting Certificate of Competency procedures can easily

¹ Lee and Dobler, Purchasing, p. 567.

² Miller, "Government Contracts and Social Control," p. 54.

delay a procurement forty-five days¹, it is obvious the delay that can result if a procurement must get over all or several of these hurdles before a contract is awarded.

Anytime an organization spends additional time and effort on a function means it is spending additional resources on that function. So it is with the assistance programs; the personnel required to implement them is an additional administrative cost that should not be discounted. For the field offices alone the Department of Defense must employ 600 (156 full time) small business specialists (usually grade 13 with an annual salary of \$15,000)² to execute the assistance programs. This amounts to a substantial cost to the government. The Small Business Administration has forty-three representatives stationed throughout the United States and approximately fifty personnel in Washington, D.C. assigned to the procurement function³, again a sizable salary burden on the government. A true estimate of the total additional administrative expense entailed by the programs would also have to include the cost of extra personnel the prime contractors must employ because of them, for it can naturally be assumed that these costs are passed on eventually to the government. However, any attempt to estimate this cost would be fruitless. It must be substantial, though. Altogether the assistance programs are a sizable burden to the government in terms of administrative expense both within its own organization and within industry.

¹U.S., Department of Defense, Armed Services Procurement Regulation, paras. 1-703 (b) and 1-705.4 (b).

²U.S., Congress, House, Committee on Government Operations, To Establish a Commission on Government Procurement, Hearings, p. 22.

³U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement, Hearings, p. 813.

Although proponents of the assistance programs are quick to point out the savings to the government the programs provide by steering business in the direction of those who frequently do it for less, from the viewpoint of the Defense Department, the programs can also often mean that more is paid for an item.¹ Whenever competition is restricted (for example, when items are set aside), it is possible, and quite probable, that the item being purchased will cost more. For, if it has been determined that a buy will be set aside for small business, any large business bids on it, even if they are lower, are discarded. In many cases the difference between what a low large business bid would be and what the lowest small business bid is could amount to a substantial differential being paid for the set-aside. As one writer states, "It should be realized, however, that to whatever extent it [the set-aside technique] may have increased the small business share, the government will have paid some price differential, albeit a hidden one."² Two vivid examples of such a differential, in both cases more obvious than hidden, were reported in the Engineering News-Record when the Association of General Contractors was attempting to get construction set-asides eliminated. As it recalled the first, it stated:

Under the set asides program, recreation areas in Tulane County, California, cost the government 12% extra when the small contractors bid got a job at \$163,400 compared with a low bid of \$145,900 from the large contractor.³

The second was a case at Newport, R.I. Naval base where:

¹U.S., Bureau of the Budget, Steering Committee on Small Business Set Asides, Review of Small Business Set Aside and Related Procurement Assistance Programs, Xerox copy dated February 21, 1967, p. 24.

²Weddell, Aiding Small Industry, p. 31.

³"Set Asides Remain a Fixture," Engineering News-Record, August, 1964, p. 26.

the government put up for bid a job estimated to cost \$125,000. The low bid of \$116,872 was rejected because the contractor was ruled "large". The second lowest bid, submitted by a "small" contractor was higher by \$20,664, but it took the job. Estimated added cost to the government 18%, says the AGC.¹

That there are price differentials and that, in fact, the government may pay a higher price because of the programs is evident in the fact that the Joint Economic Committee, in a review of government subsidy programs, actually considered the small business assistance programs to have the same impact as if a subsidy were involved.² From the viewpoint of the Department of Defense, this hardly means that the assistance programs economically favor the government.

Another aspect of the programs which might be subject to considerable criticism from the viewpoint of the Department of Defense is that the small businesses given government business through the assistance programs frequently do not have the capability to execute prime contracts. When a contractor fails to execute a contract, that is, he fails to deliver the item the government ordered in accordance with the agreed to schedule, the contract may be terminated for default. As shown on Table 13, almost all of the Navy default terminations in 1968 and 1969 were small business. As Gordon W. Rule, Director, Procurement Control and Clearance, Navy Material Command stated:

They [small business] are in a different league, Senator, and all you have to do is look in the various activities and look at their contracts that are terminated for default, and they are almost all small business people that bid and didn't know what the hell they were bidding on and couldn't handle it.³

¹Ibid.

²U.S., Congress, Joint Economic Committee, Subsidy and Subsidy Like Programs of the U.S. Government, 86th Cong., 2d sess., 1960, p. 79.

³U.S., Congress, Joint Economic Committee, Economy in Government, Hearings, p. 170.

TABLE 13

U.S. NAVY DEFAULT TERMINATIONS^a
(Over \$2,500)

| CATEGORY | FISCAL YEAR 1968 | | FISCAL YEAR 1969 | |
|----------------|------------------|---------|------------------|---------|
| | Number | Percent | Number | Percent |
| LARGE BUSINESS | 25 | 15 | 21 | 14 |
| SMALL BUSINESS | 141 | 85 | 124 | 86 |

^aSource: Termination Reports Available at Navy Material Command, Headquarters, Washington, D.C.

The reasons why small business frequently fails to perform government contracts are many. One, of course, is that they frequently lack the technical know-how. That is, although the low bidding small businesses may meet the other requirements of capacity and credit (and even tenacity and perserverance), they may lack the technical capability for contract performance. They may lack the equipment necessary to meet the exacting specifications or, in highly technical fields such as electronics and communications, the engineering knowledge to design the components. Yet, according to Mr. Gordon Rule, small businesses usually fail to perform government contracts, not because of their technical inability, but because they lack the financial resources and management capability. He stated that many small firms are started by three or four engineers who break away from an established company and create their own firm. Technically, such firms are able to produce items for the government, but they are totally unaware of all the "business" aspects of a government contract; therefore, they

frequently fail.¹ In addition the Certificate of Competency program must also share the blame for the high failure rate. Table 14 shows the percentage of contracts that were terminated for default for which a Certificate of Competency had been issued. The percentage is much higher than the overall Department of Defense default rate which averages less than one percent.²

TABLE 14

CERTIFICATE OF COMPETENCY DEFAULT TERMINATIONS^a

| Fiscal Year | Percentage of Contracts |
|----------------|-------------------------|
| 1963 | 3.56 |
| 1964 | 4.81 |
| 1965 | 4.52 |
| 1966 | 5.02 |
| 1967 | 5.27 |

^aSource: U.S., Congress, House, Select Committee on Small Business, Small Business Subcontracting and Set-Aside Programs, Hearings before the subcommittee on Government Procurement and Economic Concentration of the Select Committee on Small Business, House of Representatives, pursuant to H.R. 53, 90th Cong., 1st and 2d sess., 1968, p. 1111.

Contradictory as it may seem, problems, from the viewpoint of the Department of Defense, can also be the result of small businesses receiving awards and performing the contracts to satisfaction. When a small firm accepts a large defense contract and hires the additional employees it needs to complete the contract, it may then suddenly exceed the size limitation to be classified any longer as small business. As one Department of Defense

¹Gordon W. Rule, Director, Procurement Control and Clearance, Navy Material Command Headquarters, private interview held in Washington, D.C., September, 1970.

²U.S., Department of Defense, Terminations of Military Prime Contracts: July 1953-June 1969 (Washington, D.C.: Government Printing Office, October, 1969), p. 11.

official¹ related:

. . . some of our largest contracts to small business went in the ammunition field because of the Vietnam buildup. This year these contractors are large business; the same ones . . . The continuity of production has been such that they have had to hire more and more people, and this has taken them across the line to the point where they are now large business.²

Mr. Kennard Weddell, Assistant for Small Business, Headquarters, U.S. Air Force in 1955, tells a similar story:

When we give a small-business concern a prime contract he quite often goes out of our record system; he becomes what is officially known as large business . . . I could mention many cases where companies with 350 employees, for example, would get very difficult contracts but ones that they could handle. The next time that procurement came up they had 550 . . . By their ingenuity they had done what we think is pretty good in this country in providing a bigger payroll, and more wage earners . . .³

Although this is, in fact, the goal of the assistance programs and is, to be sure, a reflection that real "assistance" has been rendered as a result of the government contract, from the viewpoint of the Department of Defense, "So we lose our 'customers' the more business they get from us."⁴ To the Department of Defense it means that the next time a set-aside is determined for this requirement, a new source must be located. It might even mean another Competency review or any of the other resource consuming procedures. In short, from their standpoint, it will probably mean additional time and expense.

The final criticism of the assistance programs from the viewpoint of

¹Mr. Graeme C. Bannerman, then Assistant Secretary of the Navy (I&L).

²U.S., Congress, House, Select Committee on Small Business, Small Business Subcontracting and Set-Aside Programs, Hearings, p. 208.

³U.S. Congress, Senate, Select Committee on Small Business, Participation of Small Business in Military Procurement, Hearings before a subcommittee of the Select Committee on Small Business, Senate, 84th Cong., 1st sess., 1955, pp. 131-132.

⁴Ibid., p. 132.

the Department of Defense is that at every turn in their implementation it seems that the problem of "definition" looms. The source of many technical difficulties is the problem of defining "small business"; at the source of much conflict among policy makers is the problem of defining "fair share".

As is the case with most legislation intended to withstand the years, the Small Business Act contains only the most general definition of "small business" and it "passes the buck" on as far as specifics to the Small Business Administration. It states:

For the purpose of this Act, a small concern shall be deemed to be one which is independently owned and operated and which is not dominant in its field of operation. In addition to the following criteria, the Administrator [of the SBA] in making a detailed definition may use these criteria, among others: number of employees and dollar value of business. Where the number of employees is used as one of the criteria in making such definitions for any purpose of this act, the maximum number of employees which a small business concern may have under the definition shall vary from industry to industry to the extent necessary to reflect differing characteristics of such industries and take into proper account of other relevant factors.¹

Thus recognition was given already in 1953 when the small business assistance programs got their start that the term "small business" was relative. This fact was underscored at the time by Congressman Wright Patterson, a long time small business advocate, when he said,

The steel business is very big, like the automobile business. I suspect a small steel plant, to start an operation, would have to use at least four or five thousand people and yet it would be small. It would be a small business, because small business is a relative term. It depends upon the business you are in. In the case of a peanut stand, of course, there are big ones and there are little ones. Kaiser was a little business when he started in the automobile business. Even Studebaker is little business compared to General Motors, Chrysler and Ford. So whenever you use the term, it is relative in the peculiar business.²

Some would consider other things entirely in the definition and would, for

¹Small Business Act, 15 U.S.C. 631.

²U.S., Congress, House, Committee on Banking and Currency, Creation of the Small Business Administration, Hearings before the Committee on Banking and Currency, House of Representatives, 83rd Cong., 1st sess., 1953, p. 20.

example, consider small business as "that segment of business enterprise which is closely or privately held rather than widely or publicly owned and further, which is so because of necessity rather than choice."¹ Others acknowledge as did the chairman of a White House Committee on Small Business that "we must be satisfied with an approach which demands neither strict proof or strict definition."² On the other hand, the Small Business Administration has out of necessity had to come up with some guidelines. It accepts the general definition of the Small Business Act that a small business must be independently owned and not dominant in its field. From there it goes to the Standard Industrial Manual, 1967 edition, for a classification of industries; for each classification code it has established the maximum number of employees a firm can have and still be considered small business. For example, a beet sugar manufacturer can have up to 750 people and still be classified as small, while a battery manufacturer can have up to 1,000 employees.³ It also feels the restriction should include the firm's percentage of sales for that particular industry. For example, a pneumatic tire manufacturer cannot manufacture more than five percent of the total number of tires made in the U.S., if he is to be classified as small business.⁴ The primary criteria used by the Small Business Administration to define "small business", then, is the size of sales and payroll.

The second definition that causes problems is that of a "fair share". According to the Small Business Act, "it is the declared policy of the

¹White House Committee on Small Business, Why Help Small Business?, p. 2.

²Ibid., p. 3.

³U.S. Department of Defense, Armed Services Procurement Regulation, para. 1-704.4.

⁴Ibid. para. 1-704.1.

Congress . . . that a fair proportion of the total purchases and contracts . . . be placed with small business."¹ Mr. Irving Maness, Associate Administrator for Procurement and Management Assistance, Small Business Administration, in testimony before Congress stated that he felt that small business would be receiving a fair proportion when their share of the government procurement market was equal to their share of the commercial market.² The Defense Department in both its procurement regulations³ and its testimony before Congress feels somewhat different. As Deputy Assistant Secretary of Defense (Procurement) John M. Malloy stated:

A fair share is hard to quantify. I would say the objective is to provide methods whereby small business concerns are provided an equitable opportunity to compete for our business. We help them by instructing them on how we do business. In addition, we have adopted special programs to carry out the intent of the law.⁴

The two interpretations are far apart. From the viewpoint of the Department of Defense, this is the source of a lot of policy disagreements and disagreements over the way the programs are implemented. To be sure, if the Small Business Administration is working toward a percentage of government contracts going to small business that is equal to the share of the commercial business small business has, and the Department of Defense is only providing an opportunity to bid, differences are bound to arise.

Viewpoint of the Small Businessman

The assistance programs from the viewpoint of the small businessman

¹ Small Business Act, 15 U.S.C. 631.

² U.S. Congress, House, Select Committee on Small Business, Small Business: Subcontracting and Set-Aside Programs, Hearings, p. 1125.

³ Department of Defense, Armed Services Procurement Regulation, para. 1-702 (b).

⁴ U.S.; Congress, House, Committee on Government Operations, To Establish a Commission on Government Procurement, Hearings, p. 20.

have about as many good points as they have bad. They offer one big benefit: they bring him additional business, and about that he has no complaint. But at the same time they bring him a lot of seemingly unnecessary problems: he is expected to read mountains of paper; the bidding procedures are made complicated particularly by the incomplete specifications and inadequate time; it seems that he is unjustly deprived of many contracts because he is erroneously classified as nonresponsive. His major complaint, however, is that after he battles with all these problems, he doesn't come out with much profit as a result of the contract anyway. In general, from the viewpoint of the small businessman, the programs he finds fault with are the prime contract programs; he'd much rather get his share of the government defense dollar in the form of subcontracts from government prime contractors.

From the viewpoint of the small businessman, the major benefit of the assistance programs is that they increase his business. Some portion of the \$4-\$6 billion small business receives each year, he undoubtedly would not have received if the assistance programs had not been in existence. However, there is not even unanimity of feeling among the small business community that government assistance in getting prime contracts to the small businessman benefits even to this extent. A.N. Weckler in Purchasing Magazine reported that:

One of the strongest criticisms of the SBA and ASPR regulations came from a manufacturer who is widely regarded as a spokesman for small business. He told Purchasing Magazine that "government paternalism" toward small business could ultimately lead to complete dependence by small manufacturers. "Should the government take the uninitiated by the hand and lead them to defense business?" he asked. "Would it be helping or harming them?"¹

¹A.N. Weckler, "Do SBA Rules Hobble Purchasing?" Purchasing, March, 1963, p. 115.

Therefore, while the assistance programs help the small businessman to get a share of the defense dollar, this doesn't constitute a benefit in the eyes of all.

From the viewpoint of the small businessman a major problem in bidding on or performing a prime defense contract is the amount of paperwork required. One small businessman reported that a request for proposals he received was four inches thick and weighed eight and three-fourths pounds. The proposal he made was contained in fourteen separate volumes, each one inch thick. Its total weight was thirty-two pounds. All of this was for a small check valve that was in their catalog.¹ Another small businessman had these comments:

It is not necessarily the government's fault that there is a problem [paperwork burden], but what is not recognized is that most small businessmen couldn't begin to find the time to read the material nor could they afford to have a staff to do it for them. Large contractors can easily bury the cost of several staff members to read and interpret the volumes of paperwork that goes with government contracting.²

Yet the result of not reading the paperwork, particularly the specifications and directions, can be disastrous; contracts will be poorly bid, the required performance omitted, and the result undoubtedly will be a default termination.

From the viewpoint of the small businessman, government contracts are just plain difficult to bid on, too. The procedures themselves are too complicated and involve too much red tape. Frequently the specifications are incomplete, and more often than not there is not enough time for him to prepare for the bid. In the words of one small businessman:

¹U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement, Hearings, pp. 161-162.

²U.S. Congress, House, Select Committee on Small Business, Small Business Subcontracting and Set-Aside Programs, Hearings, p. 631.

Our company's means of searching out IFB's and RFQ's is the Commerce Business Weekly. From most sources upon receiving the IFB's we find them incomplete of aperture cards or prints as well as specifications. This forces us to chase down the necessary information in order to complete the bid. In doing so we find we are unable to meet closing bid date because of the lack of time.¹

An Aerospace Industries Association survey of over 1100 small businessmen indicated that one of the small businessman's biggest complaints was that government specifications were either not adequate or too complex.² When things are made so difficult just to get a foot in the door of opportunity, that is, just to bid, the programs do not seem like much assistance to the man on the receiving end.

From the viewpoint of the small businessman he loses too many contracts because of erroneous "nonresponsive and nonresponsible determinations". A bid, to be eligible for an award, must be "responsive", that is, comply completely with the Invitation For Bids. The object behind this requirement for almost literal compliance with the Invitation For Bids is to insure that no bidder has any advantage over another.³ The bidder must also be "responsible", that is, he must have the financial capability, the plant capacity, and the tenacity and perserverance to complete the contract.⁴ If the small firm doesn't comply exactly with the specifications or delivery schedule in its reply to the Invitation For Bids, or if the firm is determined to be nonresponsible, his bid is rejected or he is denied the award. Small Business feels this occurs too frequently. A Congressional

¹Ibid., p. 603

²Albert N. Schrieber, et. al., Defense Procurement and Small Business (Seattle, Washington: University of Washington Press, 1961), p. 46.

³Commerce Clearing House, 1969 Government Contracts Guide, pp. 183-184.

⁴Ibid., p. 184.

Small Business Committee recently reported that:

Many complaints were received by the subcommittee that small business firms were unjustly deprived of awards to which they were entitled due to erroneous determinations that bids were nonresponsive or that bidders were unresponsive.¹

In the Department of Defense reporting system these determinations would be reported in the category of "Small Business Bids Not Accepted-- Miscellaneous Reasons". Since 1965 such determinations have been averaging almost \$1.1 billion a year or about 3 percent of the total Department of Defense purchases.² This is too high in light of the fact that the amount set aside for small business was only 4.8 percent of the total purchases in Fiscal Year 1970.³ Also, since, as shown on Table 15, the overall success rate for small businesses in bidding on government prime contracts is so much lower than their success rate when bidding on subcontracts, it is possible that they are not being given a fair evaluation.

TABLE 15

SMALL BUSINESS SUCCESS RATE^a

| TYPE OF BIDDING | PRIME CONTRACTS (Percentage) | SUBCONTRACTS (Percentage) |
|-----------------|---------------------------------|------------------------------|
| ADVERTISED | 13.7 | 19.6 |
| NEGOTIATED | 27.4 | 43.0 |

^aSource: Albert N. Schrieber, et. al., Defense Procurement and Small Business (Seattle, Washington: University of Washington Press, 1961), p. 31. 32

¹U.S., Congress, House, Select Committee on Small Business, Position of Small Business in Government Procurement, H. Rept. 1975, p. 22.

²U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement, Hearings, p. 369.

³U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement, H. Rept. 91-1608, p. 14.

From the viewpoint of the small businessman, the effort he puts into obtaining and executing a government contract is hardly compensated for at all in terms of the money he makes; at times, in fact, he is lucky if he breaks even. For one thing, his overhead usually increases, making him less competitive in the future. Ted Valpey, President of Valpey Crystal Corporation Holston, Massachusetts, told a House Committee on Small Business:

Gentlemen, in most cases the incentive for a real profit does not exist in most government contracting . . . Government contracts require far more overhead burden than do commercial contracts. For example, some contracts require that a firm have a security officer and the measures to go with it, and a quality control officer, and both must have manuals acceptable to the Federal Government . . . Government contracts many times involve visits by auditors, engineers, contract personnel, ¹ et cetera, that all take far too much of the small businessman's time.

As shown on Table 16, one overhead charge in particular that is excessively high from the viewpoint of the small businessman is bid preparation.

TABLE 16

BID PREPARATION EXPENSE OF SMALL DEFENSE CONTRACTORS^a

| COST OF PREPARING BIDS | ADVERTISED BIDDING | | NEGOTIATED BIDDING | |
|---------------------------|----------------------------|-------------------------|----------------------------|-------------------------|
| | Prime Contracts Percent | Subcontracts Percent | Prime Contracts Percent | Subcontracts Percent |
| Excessive \ | 61.2 | 43.2 | 42.2 | 27.5 |
| Reasonable v | 31.4 \ | 50.1 v | 51.9 v | 65.9 ^ |
| Low \ | 7.4 | 6.7 | 5.9 | 6.9 |

^aSource: Albert N. Schrieber, et al., Defense Procurement and Small Business (Seattle, Washington: University of Washington Press, 1961), p. 30.

Not only does the small businessman object to the increases in his overhead

¹U.S., Congress, House, Select Committee on Small Business, Small Business Subcontracting and Set-Aside Programs, Hearings, p. 631.

caused by government contracts, but he feels that the overall profit margin he can make on a government contract is too low, especially if the prime contract is received through formal advertising procedures. Table 17 reflects the replies about profit made to the Aerospace Industries Association survey of over 1100 small business firms.

TABLE 17

PROFIT RATE OF SMALL BUSINESS DEFENSE CONTRACTORS^a

| PROFITS COMPARED TO COMMERCIAL BUSINESS | ADVERTISED BIDDING | | NEGOTIATED BIDDING | |
|---|----------------------------|-------------------------|----------------------------|-------------------------|
| | Prime Contracts Percent | Subcontracts Percent | Prime Contracts Percent | Subcontracts Percent |
| Higher \ | 2.6 | 2.5 | 3.9 | 5.5 |
| Same 0 | 27.1 | 44.2 | 42.4 | 56.9 |
| Lower) | 57.7 | 48.5 | 49.2 | 35.7 |
| Loss ~ | 12.6 | 4.8 | 4.5 | 1.9 |

^aSource: Albert N. Schriber, et al., Defense Procurement and Small Business (Seattle, Washington: University of Washington Press, 1961), p. 31.

Not only are profits lower in general for prime government contracts, but 12.6 percent of the small businessmen reported that prime government contracts awarded as the result of formal advertising actually were performed at a loss.

Finally, from the viewpoint of the small businessman, dealing with the massive bureaucracy and red tape of the Department of Defense is generally more frustrating than it is worth. Appendix I is the experience of a small businessman in trying to obtain delivery instructions for a few transistors he manufactured. Although the case may not be typical, it does show how a problem can be referred to everyone but the right person, particularly if the

individual with the problem uses the phone instead of a letter or, if urgent, a telegram. It does illustrate the kind of frustrations the small businessman may encounter.

Preference for the Subcontract

All in all the criticisms of the small businessman has for the assistance programs refer primarily to the prime contract assistance programs, when he must deal and work directly for the government. Mr. Paul Otto, President of the United Engineers Incorporated, sums up this feeling:

In recent years, however, we have become thoroughly discouraged in attempting to obtain and execute prime contracts to the point at present we are making no effort to obtain prime contracts. We are continuing to seek and perform selected subcontracts. The reasons for this change in attitude towards prime contracts has been a matter of bitter experience over the years that the effort required to obtain and execute prime contract business was just not worth it . . . With respects to our interests in subcontracting with big business, our results have been relatively productive, and we intend to continue pursuing this class of business. We have found some big businesses to be very cognizant of the small businessman's problems and most¹ helpful in providing efficient and fair arrangements for doing business.

Nationwide, small businessmen prefer to receive their share of the defense dollar as a subcontractor. The Aerospace Industries Association survey reported that of the 887 small businesses that stated a preference for doing business as a prime or a subcontractor, 632 or 80.3 percent preferred to be a subcontractor.² A major reason is the assistance a prime can give his subcontractors. If a company makes a mistake in quoting an item he is going to supply, the prime can very easily adjust the schedule or increase the cost of the contract.³ Major primes also provide engineering

¹U.S., Congress, House, Select Committee on Small Business, Position of Small Business in Government Procurement, Hearings before the subcommittee on Government Procurement of the Select Committee on Small Business, House of Representatives, pursuant to H.R. 13, 89th Cong., 2d sess., 1966, p. 219.

²Schrieber, et al., Defense Procurement, p. 28 and p. 105.

³Interview with Gordon W. Rule.

assistance, production control assistance, procurement assistance, etc., not necessarily out of the goodness of their hearts, but to keep the subcontractor's and subsequently the prime's costs as low as possible.¹

The only real major complaint the small businessman has for the subcontracting program involves the method the Department of Defense uses to negotiate profit for the large primes. The procedure is called the "Weighted Guidelines Method of Profit Negotiation"². It is used for most negotiated contracts or changes that are over \$100,000. It consists of "analyzing the costs, risks, and achievement elements incident to a particular procurement in terms of a standard set of 'profit factors'."³ This means that profit factors are each assigned a range of weights. For instance, the amount of risk a contractor assumes is weighted from zero to seven percent, that is, on low risk contracts (cost type) he receives a zero or one percent profit rating; for high risk contracts (fixed price) he would receive a five to seven percent profit rating. The emphasis of the Weighted Guidelines is on the contractor's input to total performance, that is, he receives a higher profit for work that he does in his own factory than for work he subcontracts. For example, engineering labor (an in house effort) is weighted from nine to fifteen percent, while subcontracted effort is weighted one to five percent. The past performance of the prime contractor in regard to the success of his small business subcontracting program is grouped with his past performance in eight other areas (Cost Reduction Program, Value Engineering Program, etc.). The weight applied to the contractor's total record of past performance is from minus two to plus

¹U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement, Hearings, p. 1127.

²Commerce Clearing House, 1969 Government Contracts Guide, p. 242.

³U.S., Department of Defense, Armed Services Procurement Regulation, para. 3-808.2.

two percent. This gives the prime contractor little profit incentive to emphasize his small business program.

Because of the Weighted Guidelines approach to profit, small businesses feel that a major prime contractor has a tendency not to subcontract items if at all possible. Their feelings were confirmed by Mr. Rulon Nagley of North American Corporation in a speech before the Strategic Industries Association in June of 1964, when he said,

I might as well lay it on the line and level with you guys. If we buy from you we get 2% profit. ¹If we make it ourselves, we are allowed to keep 9%. What would you do?

Summary

An evaluation of the small business assistance programs from the viewpoint of the Small Business Administration would be a favorable one. The programs are effective in their mission: they channel several billions of dollars worth of contracts to the small businessman. They increase the number of suppliers, thus stimulating the economy, lowering prices (i.e., saving the government money), broadening the country's mobilization base, and providing opportunity for a segment of industry which is frequently the most innovative. The programs could be even more effective if, from the viewpoint of the Small Business Administration, the Department of Defense made a more wholehearted effort. Many times small firms don't even get a chance to bid on contracts they could handle and don't get awards for contracts they bid on only because of a wide policy/procedure gap in the buying activities.

The success of the programs from the viewpoint of the Department of Defense is measured more critically. They point to the many problems they

¹U.S., Congress, House, Select Committee on Small Business, Small Business Subcontracting and Set-Aside Programs, Hearings, p. 93.

incur in trying to fulfill two conflicting objectives. The programs tend to restrict competition, give preference to some bidders, and decrease the vendor selection authority of the contracting officer. The programs consume a great deal of administrative time and effort and therefore cost the government additional money. And, they frequently mean that the government must pay more for an item. Finally, the Department of Defense laments the high small business default rate, especially for those contracts for which a Certificate of Competency had been issued.

Even from the viewpoint of the small businessman, the programs have much room for improvement. To be sure, he likes the additional business the Defense contract brings. However, he is discouraged with the effort required to obtain and execute prime defense contracts. They demand excessive paperwork, and the specifications provided by the Department of Defense are frequently incomplete and difficult to understand. The very things the Small Business Administration feels are beneficial about the programs (they result in more competition and lower costs) are disadvantageous to the small businessman. He makes less money on defense contracts because of the additional overhead and because of the stiff competition in advertised procurements. The small businessman also objects to the Department of Defense's less than enthusiastic attitude toward him, particularly when the contracting officer frequently makes nonresponsive determinations that prevent him from receiving an award. It is no surprise, then, that the small firm prefers the subcontract over the prime contract by a four to one ratio. His one criticism of the subcontracting program is that the Weighted Guidelines method of determining profit is oriented too much in favor of a prime contractor's doing the work himself instead of subcontracting it. From the small businessman's viewpoint, the subcontract program is much more effective.

CHAPTER V

SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

Summary

This, then, is the situation as it stands. Years of awareness in this country of the importance of the small business enterprise to the nation's economy, security, and well being have generated the development of policies entitling the small businessman to a share of government business. Four present day Department of Defense small business assistance programs are a consequence of these policies. All were the joint effort of industry, Congress, and various Executive departments, including the Department of Defense and the Small Business Administration, a government agency created in 1953 to provide small business assistance of many kinds (financial, managerial and procurement). Two of the Department of Defense programs consist of procedures which assist small business to receive part of the defense dollar through subcontracts. This may mean, particularly for developing minority enterprise, subcontracting from the Small Business Administration; otherwise, it means subcontracting from major government prime or subcontractors. The two other assistance programs help the small businessman to receive prime government contract awards. Either they insure that a certain amount of contracts are set aside solely for him, or they support, guide, and give preference to him when he competes against large business on his own for these contracts.

How have these programs been faring since their inception seventeen

years ago? There are various opinions. To evaluate the programs from the viewpoint of the Small Business Administration would provide an encouraging outlook as to how they're doing. Here is an organization committed to the good of assisting small enterprise. It considers the billions of defense dollars going to the small businessman from prime and subcontracts a big help in that effort. The viewpoint of the Department of Defense, on the other hand, is apt to be more critical. Here is an organization committed in its purchasing of requirements for national defense to getting the best combination of price and quality. Burdensome administrative effort and expense that particularly the prime contract programs demand it feels must be counted in the price of items purchased from small business. So should be the added cost to the government when contracts are terminated for default, as is more often the case with small business. And how about the small businessman, himself? He is an individual enterprise committed to making a fair profit. He doesn't mind the business he gets from the government, but often if he subtracts from his profit the cost of the effort he has to go through to obtain and perform particularly prime contracts, he isn't very far ahead. In general he prefers the subcontract program.

Conclusions

What can be deduced from these viewpoints? Looking at all three objectively, have to date the Department of Defense small business assistance programs been productive in their efforts? Or, considering the intent of Congress and the stated policies of the Department of Defense, "How effective is the Defense contract in providing assistance to the small businessman?"

The evaluation of the programs from the viewpoint of the three groups involved with them indicated that there is no simple answer to this question. That as a group they are in many ways effective cannot be denied.

On the other hand, many of the procedures involved in particular programs make them so ineffective as to weigh heavily on the other side of the balance in the evaluation of all.

Two things are clearly indicated, however, when the assistance programs are observed from all sides: 1) the prime contract is not a very effective way to assist the small businessman; and 2) for everyone concerned the subcontract is a much better way of providing the assistance to small enterprise that the Congress intended.

The two programs which assist the small businessman in obtaining prime government contract are fraught with far more limitations than benefits; hence they are not very effective. Their ultimate benefit is that they increase the number of suppliers in the country, and this results in more competition among suppliers, lower costs to buyers (including the Department of Defense) and a dispersion of economic power in U.S. industry.

However, in the set-aside program in particular, the procedures are for the most part so cumbersome, tedious, and time consuming that they raise objections from all sides. Of all the assistance programs, it is the set-aside program which involves the most resources. The administrative effort required to implement it requires several hundred government employees alone. For all this effort and expense, only a small percent of the dollars spent by the Department of Defense ever reaches the small businessman by this means. Additionally some portion of these awards probably could have gone to him anyway, since in order to have a contract set aside, he must have proved his capability to produce the item, i.e., he may many times have also been capable of competing successfully for the award without the set-aside.

What about the effectiveness of the assistance measures the government provides when the small businessman competes on his own for prime

contracts? It is in this arena that the small businessman receives the most prime contracts. (He receives 15% of the total prime contracts awarded.) Here, however, the government offers only the barest minimum of assistance and spends next to no resources. It is not very effective to spend the least resources on the program that produces more results, i.e., more contracts.

All in all, then, many of the criticisms the small businessman has for the prime contract assistance programs are valid. Any programs that involve so much paperwork and require so much additional overhead that profits end up to be minimal are not providing very effective assistance. Likewise, when programs such as these sometimes result in terminations of contracts for default, they hardly add up to assistance at all; they might even be considered a disservice.

The subcontract is a much more effective vehicle of assistance for small business. Both the Department of Defense, which does most of the implementing of the programs, and the small businessman, who performs the contracts, prefer the subcontract programs by a wide margin.

The Department of Defense prefers the subcontract program because it requires very little administrative effort on the part of its organization. It is also less costly, for, although the cost of prime contractors' subcontract programs are eventually passed on to the government in one form or another, this probably amounts to substantially less than the cost of administering programs directly.

The small businessman prefers the subcontract, too. He would rather work for and deal with industry than the Department of Defense, because prime contractors can and do operate differently than the government. They provide all kinds of assistance which would be impossible for the government

to offer, and they generally operate in a less formal and more flexible environment.

The biggest plus for the subcontract program in terms of both the small businessman and the government is that the value of the contracts small business receives from subcontracts is much more (\$4.4 billion in 1970) than the value received from the primary prime contract assistance program, the set-aside (\$1.4 billion in 1970). Since more defense dollars are received by the small businessman, and less resources are consumed by the government, the subcontract program is a considerably more effective means of assisting the small businessman.

Recommendations

Based on these conclusions, where might the government head from here in its small business assistance efforts? Considering the existing programs, the size of the organizations involved with the programs as they are, and the difficulties involved in any major change in a government institution, how might the programs be headed in a direction of more positive assistance from all viewpoints? What exactly could be done to make the defense contract a more effective means of assisting small business?

It would be inconsistent, unfortunate, and illogical to recommend that the government dispense with those programs that are ineffective in their present form, that is, the prime contract programs. In actuality they have the potential to offer a great deal of assistance and the organization already established for implementing them. And, to get rid of them would be an impossible task at best. However, the prime contract program could be improved dramatically if more genuine assistance was provided the small businessman in obtaining and performing prime government contracts. That is, they could be improved if 1) more prime contracts were

offered to the small businessman to bid on, 2) more preference was given to him when he competed on his own for prime contracts, and 3) all of the procedures involved in the programs were made easier for him.

Assuming that more contracts means more assistance, the first way to improve the prime contract assistance programs would be to offer more contracts to small business. This could be accomplished by increasing the number of set-asides made to small firms, or by including more small businesses on the bidders lists for procurements that are now only advertised to large business (a large business set-aside, if you will). There is a definite correlation between the value of contracts awarded small business and the number of contracts for which small firms are asked to bid.

A second way the prime contract programs could be improved would be to offer more preferential treatment to the small businessman when he is competing against large business. There is a way to do this which would be easy to administer. That would be to give small business a price differential, that is, award small business the contract if its bid was within a certain percent (say 15%) of the low large business bid. As one writer suggested:

Open price differentials are not today authorized in the United States, although they were in World War II. There is considerable validity to the argument, backed up by experience, that of the two methods of providing preferential treatment to tenders, the authorization of out-and-out price differentials presents fewer problems than does the making of set-asides.¹

Price differentials are currently being used with success in India to assist the small businessman. There the contracting officer can, on his own, grant a fifteen percent price differential to small business. The contracting officer's supervisor has the authority to approve differentials of more than

¹Weddell, Aiding Small Business, p. 31.

this as long as the total value of the contract is within his approval authority. The India program is exemplary in that it is successful and consumes very little government resources.¹ Since in our country hidden differentials are frequently paid small business in the set-aside program anyway, it seems logical to allow them on all prime contracts awarded small business. Such a program seems at first to mean additional expense to the government, since the purchased items would cost more. However, if price differentials were used, there would be little or no reason to continue with the complex, resource consuming set-aside program.

A third way the prime contract programs could be improved would be to make the procedures involved in them a lot easier. This would mean eliminating the red tape and decreasing the amount of paperwork required, both of which are easier said than done. Specifications could also be improved and made easier to understand. The bidding time certainly could be lengthened so that the small businessman had time to read the specifications and other material. In general the Department of Defense procedures and policies could be more flexible and less tedious. If a prime contractor can buy an item that will be incorporated into a major weapons system in a flexible and simple manner, why can't the Department of Defense do the same? Finally, great strides could be made in the prime contract programs if effort was made to close the policy/performance gap throughout the organization. There is a big difference between what is expounded by the Secretaries and the Assistant Secretaries of the military services about small business assistance policy and what is practiced in the field.

¹Jedish Prasad, former Assistant Director of Purchasing, India Supply Mission, Washington, D.C., private interview held October, 1970, Washington, D.C.

Like Rome, none of these changes could be "built in a day". The most difficult would be the closing of the policy/performance gap, simplifying the procedures, and eliminating the red tape; these to date unsolved problems face all bureaucratic organizations. The change that would require the least effort and which would improve the programs immensely, however, would be the use of price differentials.

There is also room for improvement in the subcontracting programs. The Weighted Guidelines Policy needs revision, and prime contractors should be either motivated or required to improve their small business subcontract award rate.

Many acknowledge the need for revising the Weighted Guidelines policy. As a President's Task Force on Improving the Prospects of Small Business reported:

Much has been attempted through set-asides and other programs to enable small business to get a fair share of Government contract work. This is hard to accomplish however. Government often finds it simpler and more economical to contract in large amounts with known reliable suppliers. We suggest a further incentive to prime contractors to seek out small business and subcontract to them. We recommend that the weighted average guidelines of the Department of Defense and any similar list of factors influencing profit allowances . . . include a specific guideline¹ sufficient to motivate contractors to subcontract to small business.

Two changes in the Weighted Guidelines must be made. First, small business performance must be identified as a separate item to be considered in weighing profits, and secondly, a high weight must be given to this separate item. This would provide incentive to the prime contractor to subcontract to small business rather than make in-house.

The government could also improve the subcontract program by requiring that prime contracts include in them a requirement that a certain

¹The Report of the President's Task Force on Improving the Prospects of Small Business (Washington, D.C.: Government Printing Office, 1970), pp. 9-10.

percentage of the contract effort be subcontracted (set aside, in other words) for small business. In 1967 the Navy awarded such a contract. It required the prime contractor to award twenty-five percent of the prime contract price to small business. The effort was so successful that the Navy recommended that it be used throughout the Defense Department.¹ The recommendation is a valid one.

Small business, then, is not only a vital part of the economy of the United States, but also provides an important system of suppliers of defense material. Assisting the small businessman, therefore, furthers the needs of our society in many ways. The defense contract is one method that can be used to assist him. However, this is not currently being done in the most effective manner. The programs could be made more valuable to the small businessman, the Department of Defense, and society in general if the above changes were made.

¹U.S., Congress, House, Select Committee on Small Business, Small Business in Government Procurement, H.Rept. 91-1608, p. 29.

APPENDIX I

ONE SMALL BUSINESSMAN'S DEALINGS WITH THE GOVERNMENT

One single ring-around-the-rosy experience we had concerning a particular Navy contract not too long ago is just one of many such episodes with which we have been burdened in the past. In that regard, the subject matter was a contract of October 3, 1966 from the Naval Ships Systems Command in Washington, D.C. calling for sixty eight pieces of transistors for a mere total amount of \$816.00. This order called for delivery of the items by April 1, 1967. The contract items were ready for shipment by us on March 17, 1967. On March 15, two days prior, we contacted the Administrative Contracting Officer at the Boston DCASR office for information regarding the shipping destinations for these units which we had been waiting for since the contract was awarded in October of 1966. At that time, the Boston DCASR contact referred us to another party in the DCASR transportation section. In contacting him, he in turn referred us to still another party who stated his belief that this material was intended for new ships and that we would have to go directly to the Navy department in Washington for further instructions.

We then called the Navy Contracting Officer in Washington whose signature appeared on the contract document itself. He, in turn, advised us that his responsibility was limited only to signing the contract and that another party was actually administering the contract. We tried to reach this other party for four days, each time leaving word for him to return our call, which he never did. We were finally able to reach him upon our third attempt of the fourth day. He advised us that he could not give us the shipping instructions we were in need of and stated that we would have to contact another person. We phoned this other person at the number given us, but that department had no knowledge of such a man and we were advised that someone else might be able to help us. We called this someone else who in turn advised us again that this was not her contract responsibility either but that perhaps still another person could be of help. We called this last

party but she was not at her desk so we left word for her to call us back, which she finally did and stated that although she knew the destination assignments we were seeking she was not at liberty to give us this information, stating further that we would have to talk to someone in the Nomenclature Division and confirm the nomenclature of the material with him after which he would file proper forms with her so that she could file some other forms with the Navy to obtain a Federal Stock Number for the material on order with us and after which she would be able to give us the destination instructions we were in need of. She further told us that there would be a minimum of thirty days required for her to obtain this FSN, and then naturally thereafter, there would be still another delay in confirming the nomenclature data.

As a result, we called a previous party again to inform him of this confusion. He told us that we would have to complete a DD Form 61 and send it back to him for processing, after which he would advise another office to apply for a FSN, and after which we would then finally be advised of the long sought destination instructions. As a result of this chain of events we again called upon the Boston DCASR office to request the proper DD Form 61. By this time, of course, we were quite completely appalled at the costly and time consuming run-around we were being given by government personnel. We studied, and re-studied, the Navy contract several times and were unable to find any information therein whatsoever requiring us in any way to confirm such nomenclature. We bid this contract for the item that was required, as completely spelled out in MIL SPECS. Furthermore, we had supplied this very item on another Government contract and also had Government first article approval on it. Quite irked by this time, we called the Washington contact again and confronted her with the fact that our contract did not call for us to confirm item nomenclature. As a result, she herself studied the contract and admitted that she could not find any reference to such requirement and stated that she would have to request her contract officials to examine the government order and validate our mutual conclusion. She called back the next day and advised us that we were not obligated to confirm the nomenclature but said further that she would still have to obtain a Federal Stock Number anyway which would require a minimum of thirty days as stated earlier by her . . .

This fiasco continued in the same vein for several additional weeks thereafter, and it was also a subject matter in a series of scorching

communications between our company and the Boston DCASR office Director who was told in no uncertain terms that we had been getting this aggravating run-around for several weeks by both Washington and his own agency as well. He finally admitted the situation to be the government's fault which was certainly of little consolation to us . . . All told, we had to chase at least twelve government representatives, and on more than one occasion each, by way of a multitude of costly long distance calls over a period of several weeks.

Although this extravaganza of errors was admittedly on the government's part and totally beyond our control, it can hardly be considered fair or justified that our company should be caused such suffering and time loss of many man hours for which we can never recover. . . It is conservative to state that this \$816.00 contract with the government resulted in costs to us in excess of \$2500.00. In fact, just as a test, we sent a letter to the Navy on June 23 asking them to pay us a very minimal storage cost of \$1.00 a day for their long held merchandise. We never even had the courtesy of a reply.

This is a typical case of contract laxities on the part of the government, and especially of their gross mishandling and inattentiveness to a serious problem.^a

^a
Source: U.S., Congress, House, Select Committee on Small Business, Small Business Subcontracting and Set-Aside Programs, Hearings before the subcommittee on Government Procurement and Economic Concentration of the Select Committee on Small Business, House of Representatives, pursuant to H.R. 53, 90th Cong., 1st and 2d sess., 1968, pp. 611-613.

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